bO2 Corporate Essentials

Tax Smart Australia

Issue
#0090

Tax Essentials
Superannuation
(Wealth Accumulation Tips)

DECEMBER	2017

THE NEWSLETTER
Tax Planning Opportunities for Everyday Business

LEIGH'S CORNER
The Work Health & Safety and Other Legislation Amendments Act (QLD) 2017

Article No.38

SPECIAL BONUS ISSUE
Superannuation - (Wealth Accumulation Tips)

ANOTHER ESSENTIAL TAX SMART AUSTRALIA RESOURCE · CLARITY · CONVENIENCE · CONFIDENCE ·

bO2.com.au

Contents

The Newsletter

SINGLE TOUCH PAYROLL REPORTING

The A.T.O'S introduction of the **Single Touch Payroll Reporting (STPR)** is set to streamline the way employers report some tax and superannuation information to the A.T.O. While there will be some immediate administrative benefits for early conformers, the introduction of STPR is compulsory from:

o 1.7.2018 for businesses that employ more than 20 people

o 1.7.2019 for businesses that employ less than 20 people

Some of the Main Changes Include

- Ordinary Time Earnings, salary or wages and PAYG withholding information will be reported and available to the Commissioner in 'real time' when payroll is periodically processed by the employer
- Employers will need to acquire SBR-enabled software to comply with their PAYG withholding obligations
- New employees will be able to prepare TFN declarations and Super Choice forms online
- The STPR reports for PAYG withholding will become the approved form for reporting PAYG withholding (currently this information is in the activity statements)
- Employers that have reported their PAYG withholding obligations via STPR will have their PAYG withholding prefilled by the A.T.O on their BAS
- Large withholders will no longer report PAYG withholding on their activity statement
- Employers will be provided with the option to pay their PAYG withholding at the same time they lodge their STP reports to further align the reporting and payment of PAYG withholding through the payroll system
- Employers will no longer be required to submit an annual PAYG summary report to the A.T.O

It is possible employers may no longer need to provide annual payment summaries to employees who will have access to their payroll information via their myGov account.

Action to Be Taken

Understanding the changes and how they apply to your organisation and beginning the planning process will help provide a smooth transition to this new reporting requirement.

Well before the compulsory 1.7.2018 start date for business that employ more than 20 people, your payroll system will need to be STPR enabled to comply with the new law. Additional costs may be incurred by employers, particularly those that do not currently use software based payroll systems or out-of-date payroll software systems. There are a range of payroll software providers now working with the A.T.O on product updates from 1.8.2017 to ensure STPR enablement.

Relevant employers should review their company's SGC and PAYG payroll processes to ensure the treatment of all types of payments and remuneration are correct well before the two deadlines.

Three Crucial Steps to Get Things Started

- Consult with your accounting software provider to establish the current payroll processing arrangements will support the changes
- Conduct a detailed risk review of your current payroll procedures, including PAYG, superannuation, allowances, payroll deductions and the timeliness of payments
- Your HR processes should be reviewed and monitored to ensure employees are being treated fairly and paid correctly.

THE BUDGET ANNOUNCEMENTS AND THE HOUSING TAX INTEGRITY BILL 2017

The budget announcements directed at housing affordability included two curious measures, one denying travel expenses to inspect a rental property and the other directed at subsequent owners of rental properties claiming depreciation deductions in excess of the value of assets acquired with the rental property. Treasury Laws Amendment (Housing Tax Integrity) Bill 2017 containing these measures was tabled on 7 September. Notably, the provision purporting to implement the second of these proposals is the proverbial sledge hammer to crush a walnut, requiring complex exclusions.

TRAVEL EXPENSES AND RESIDENTIAL PROPERTY

This was announced in the Federal Budget handed down 9.5.2017, a new s26-31 of the ITAA 1997 denies a deduction for to travel incurred in gaining assessable income from the use of residential premises as residential accommodation from 1.7.2017. Such expenditure cannot form part of the property's cost base for capital gains tax purposes.

Exceptions include the expenditure incurred in carrying on a business or by a corporate tax entity. Also, if the premises are also used for other income-producing purposes then travel for those purposes remains deductible. Apportionment may be possible in the event of mixed travel purposes.

Deductions will remain available for a taxpayer conducting a boarding house or similar type arrangement that constitutes a business. Estate agents acting on behalf of a landlord client will also be entitled to a deduction. And, where the agent passes on the travel costs in their fees, the landlord is will not to be denied a deduction.

The availability of travel expenses by a company (although not a corporate trustee) may lead to some planning opportunities depending on a client's circumstances.

SHARE CAPITAL – SPECIAL LEAVE APPLICATION REFUSED BY HIGH COURT

In this case, High Court has refused the taxpayer's special leave application to appeal against the Full Federal Court's decision *Cable & Wireless Australia & Pacific Holding BV (in liquidation) v Commissioner of Taxation [2017] FCAFC 71.*

The Full Federal Court held that a 'buy-back reserve' account was not a share capital account such that the debit entry to the buy-back reserve did not record a transaction reducing share capital. Accordingly, the transaction was correctly treated as a dividend that was subject to withholding tax.

REFORMS TO STOP CORPORATE AVOIDANCE OF EMPLOYEE ENTITLEMENTS AT TAXPAYERS' EXPENSE

The Government will introduce new laws to stop corporate misuse of the Australian Government's Fair Entitlements Guarantee (FEG) scheme.

It is clear that some company directors are misusing the FEG scheme to meet liabilities that can and should be paid directly by the employer rather than be passed on to Australian taxpayers. The FEG scheme is an avenue of last resort that assists employees when their employer's business fails, and the employer has not made adequate provision for employee entitlements.

The proposed changes will provide a significant disincentive for employers to exploit the taxpayer-funded scheme and avoid their responsibilities to their employees. The changes will:

- penalise company directors and other persons who engage in transactions which are directed at preventing, avoiding or reducing employer liability for employee entitlements
- ensure recovery of FEG from other entities in a corporate group where it would be just and equitable and where those other entities have utilised the human resources of the insolvent entity on other than arm's length terms
- strengthen the ability under the law to sanction directors and company officers with a track record of insolvencies where FEG is repeatedly relied upon.

Costs under the FEG scheme have dramatically increased in recent years with FEG payments totalling more than $1 billion between 2012-13 and 2015-16. There is increasing evidence that some employers are deliberately structuring their corporate affairs to avoid paying employee entitlements when a business becomes insolvent.

The Government's proposed changes to the Corporations Act will deter those businesses from engaging in practices that inappropriately shift costs onto FEG, while strengthening the ability to pursue recovery of FEG costs.

These changes will be targeted to deter and punish only those who have inappropriately relied on FEG. They will not affect the overwhelming majority of companies who are doing the right thing.

These changes build on the Government's commitment to pursuing recovery of FEG payments from company directors through the FEG Recovery Program, which was established by the Coalition Government in 2015.

The Government is taking action to ensure employers are held responsible for paying their workers and that taxpayers are protected from corporate abuse of the FEG scheme.

The legislation will also support the Australian Government's 'Comprehensive Package of Reforms to Address Illegal Phoenixing' announced on 12 September 2017.

R & D FRAUDSTERS IN THE GOVERNMENT'S SIGHTS

The recent successful prosecution against Melbourne tax agent Arjuna Samarakoon for defrauding the Australian Government highlights the Government's commitment to ensuring the Research and Development (R&D) tax incentive supports only honest taxpayers.

Mr Samarakoon was charged with money laundering offences after transferring $380,000 from company accounts to his own personal account, and has been sentenced to 29 months' imprisonment.

The Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP, said criminals who seek to defraud the Commonwealth through fraudulent R&D tax incentive claims are being put on notice by the Serious Financial Crime Taskforce (SFCT), who are now taking priority action to stamp out this behaviour.

Businesses undertaking legitimate R&D activities may be eligible to claim a tax offset under the R&D tax incentive. However, these claims must be for legitimate research and development. The scheme is administered by the Australian Taxation Office (A.T.O) and the Department of Industry, Innovation and Science (DIIS), and requires applicants to self-assess their eligibility.

The SFCT is actively pursuing taxpayers who make claims which they are not entitled to, preventing the loss of millions of taxpayer dollars.

Currently, there are approximately 15,000 AusIndustry registrants for the R&D incentive and a further 13,000 have already claimed through the A.T.O. In 2016-17 total R&D tax offsets was $6.1 billion, of which $3.6 billion were refundable offsets. While most of these claims are legitimate, the Government takes all matters of fraud seriously.

"Unfortunately, there are those who believe they can game the system for their own advantage. Our message to those people is you will be caught, and you will face the consequences," Minister O'Dwyer said.

With increased focus from the SFCT, R&D tax offset claims will be scrutinised for blatant abuse.

"Under the SFCT agencies can make better use of their resources, data-matching capabilities and intelligence-sharing relationships to uncover the most intricately planned tax fraud schemes," Minister O'Dwyer said.

G.S.T TREATMENT OF DIGITAL CURRENCY

The Treasury Laws Amendment (2017 measures N06) Bill 2017 was introduced into the House of Reps on 14.9.2017. This amends the G.S.T. Act to ensure that supplies of digital currency receive equivalent G.S.T treatment to supplies of money.

CONSULTATION ON CONSOLIDATION INTEGRITY MEASURES

On 11.9.2017, The Minister for Revenue and Financial Service, the Hon Kelly O'Dwyer MP released draft tax consolidation legislation and an explanatory memorandum for public consultation.

These important measures restore integrity to the tax consolidation rules, making sure they are operating as intended and providing appropriate tax outcomes. They continue the work of the Turnbull Government in strengthening our corporate tax system.

The tax consolidation rules allow wholly owned groups to choose to form a 'consolidated group' for tax purposes, which is treated as a single entity for tax purposes.

The Bill contains six measures designed to remove anomalous tax outcomes that arise under the tax cost setting rules when an entity leaves or joins a tax consolidated group. These measures:

- prevent a double benefit from arising in relation to deductible liabilities when an entity joins a consolidated group;
- ensure that deferred tax liabilities are disregarded;
- remove anomalies that arise when an entity holding securitised assets joins or leaves a consolidated group;
- prevent unintended benefits from arising when a foreign resident ceases to hold membership interests in a joining entity in certain circumstances;
- clarify the outcomes that arise when an entity holding financial arrangements leaves a consolidated group; and
- clarify the treatment of intra group liabilities when an entity leaves a consolidated group.

These measures address concerns raised in the Board of Taxation's post-implementation review of the consolidation rules.

BRACKET CREEPING ME OUT

As Government debt has edged over $500 billion getting the Federal Budget back into surplus has assumed more urgency.

In September the Parliamentary Budget Office (P.B.O) issued a report which showed their 2017-18 Budget medium-term projections report identified that the projected return to surplus in 2020-21 is predominantly due to a projected increase in personal income tax revenue.

The average tax rate faced by individuals is estimated to increase by 2.3 percentage points over the period from 2017-18 to 2021-22. The report examines how the projected increase in the average tax rate is expected to vary across individual taxpayers in different parts of the taxable income distribution.

The average tax rate for individuals in every income quintile is projected to increase over the period from 2017-18 to 2021-22. The largest increase is expected to be faced by individuals in the middle income quintile, whose taxable income is expected to average $46,000 in 2017-18. This group of taxpayers is projected to face an increase in their average tax rate of 3.2 percentages points by 2021-22, as a higher proportion of their income is taxed at the 32.5 per cent rate. Their average tax rate is expected to increase from 14.9 per cent to 18.2 per cent.

Increases in the average tax rate of between 1.9 and 2.5 percentage points are projected for individuals in the second, fourth and fifth quintile. The average tax rate for individuals in the lowest quintile is projected to rise by only 0.2 percentage points because most of their income remains below the effective tax-free threshold.

Across all quintiles, the largest driver of the increase in average tax rates in expected increases in nominal incomes. This reflects the impact of bracket creep, on account of both inflation and real income growth. In addition to the effect of nominal income growth, average tax rates are projected to increase due to policy changes, most notably the policy decision to increase the Medicare Levy from 2019-20.

WHAT DOES THE DEPRECIATION DEDUCTION DENIAL MEAN FOR DEVELOPERS?

We covered this in our budget edition #0087 and property bonus edition #0089. For contracts signed after 9.5.2017, depreciation deductions are no longer available to purchasers of second hand property. This will be topical for developers trying to sell inner city apartments in the next two years.

It should be stressed that while the housing tax integrity bill has a carve out for new residential premises (s40-27(47), with an oversupply looming in some markets, developers may decide to lease to a short term tenant in the expectation the market may improve.

The exclusion from the denial of deductions to the subsequent purchase is six months from becoming new.

Purchasers other than owner occupiers i.e. investors need to be aware of these changes and how their after tax net yield is affected. Developers who hang on to properties in the circumstances above, for more 6 months can expect purchasers to be aware of the changes and have this factored into negotiations.

Property owners who want to subsequently let out their family home

In this case the tax imperative would be to move into the new premises the old chattels as they will not be tax deductible. This is because the depreciation deduction denial also applies to an asset that was bought new but used by a landlord for a non-taxable use. An option would be to move out and purchase new assets - this may not be affordable and /or practicable. And of course, there are some assets that cannot be sensibly removed including common property. The take out is that developers, landlords and purchasers of second hand properties, need to have a sound understanding of these changes and how they are affected.

PASSIVE INCOME –SMALL BUSINESS CORPORATE TAX RATE: EXPOSURE DRAFT LEGISLATION RELEASED

We have covered this matter in past tax updates and note that in September, the Treasury released its exposure draft legislation regarding its proposal to limit the small business corporate tax rate to companies that do not exceed a passive income threshold of 80%.

Currently, a company that carries on business and does not exceed the aggregated turnover threshold (being $25 million for 30.06.2018 and $50 million for 30.06.2019) is eligible to apply the lower corporate tax rate of 27.5%.

In order to access the lower rate, it is required that a company's passive income must not be 80% or more of its assessable income in any financial year. Passive income includes rent, royalties, capital gains, interest (subject to certain exclusions) and trust or partnership income (to the extent that it consists of passive income).

The proposed amendment:

- Applies retrospectively to 1.7.2016 and therefore may require amendment to tax returns lodged on the premise that pure passive investment companies were eligible for the lower rate.
- A large capital gain could result in a company failing the 80% passive income test, resulting in the standard tax rate of 30% would apply to all the company's assessable income for that year.
- Those seeking to direct passive income into a trading company must carefully consider insolvency risk and asset protection.

When small companies on the 27.5% tax rate pay dividends, the total tax paid by the company and shareholders will be greater than if the company remained at the 30% tax rate. In effect, the extra tax arises due to the trapped franking credits in the company which is a real tax cost for the shareholder. This results because it increases the top-up tax payable by the shareholders, and the 2.5% franking credits left behind in the company are effectively wasted. This first became apparent in companies with less than $10m turnover that became entitled to the 27.5% tax rate from 1 July 2016. In the future this problem will be exacerbated when the 27.5% tax rate kicks in for companies with less than $25m turnover for the 2018 financial year and $50m turnover for the 2019 financial year.

CONSULTATION ON THE DEFINITION OF 'TAXI' FOR FBT

The A.T.O is currently consulting on the:

- Definition of 'taxi' contained in the Fringe Benefits Tax Assessment Act 1986
- Exemption from fringe benefit tax travel taken to or from work due to illness.

Currently, taxi trips to and from work that are provided to an employee due to illness are exempt from fringe benefits. However trips taken with ride sourcing or hire car trips are not.

The A.T.O is inviting comment on extending this exemption by broadening the interpretation of 'taxi' to include:

- Vehicles licensed to provide taxi services, including rank and hail services
- Ride-sourcing vehicles
- Other vehicles for hire

Feedback on this consultation closed on 24 October 2017 but we will keep you informed on developments.

bO2 READERS QUESTIONS AND ANSWERS............

Question 1

Purchase of farming property in May 2013 for $1,600,000 in the family trust. The family trust is a business of primary production. This 160-acre property has since been rezoned to residential R1 and approximately 800 lots will be available for sale at 550 sq. metre minimum lot sizes.

We plan to sell the 160-acre property prior to development with the Development Control Plan approval by council in approximately 12 months' time.

My question is, will this property sale be taxed as an active asset being able to access the small business concession. Our income is gross $400,000pa. well below the threshold to qualify.

Answer

Given the turnover the capital gains tax small business concessions can be accessed if we are dealing with active assets. In the event you have genuinely conducted a business of primary production and the land has not been mixed use... i.e. partly used for agistment, then the property would appear to be an active asset. Note than in your particular case the land must have been an active asset (i.e. used in a business) for at least half the period of ownership. Also "passive income" such as agistment does not meet this test. Of course, if you did the subdivision yourself, there could be problems, but we note the plan is to sell the land before then. We stress however that specialist advice should be sought as we do not have the full facts and circumstances.

Question 2

I have a Corporate Client who is selling off part of a Client Base and I'm unsure of the Tax Consequences, although it does appear to be a CGT Event.

The Sale Price is expected to be $175,000.

A Cost base is yet to be established, but it will probably be between $40,000 and $80,000.

It's all Goodwill.

The ATO have suggested that TR 1999/16 and TR 2005/16 may help me.

The Corporate Client has been operating for some 13 years.

Answer

Let's work on the basis that the capital gain is a notional $115k.

Example 2 in TR 1999/16 indicates we are dealing with goodwill, but this would have to be determined and confirmed from the terms and conditions of the sale.

We do not see how TR 2005/16 is relevant in any way as this deals with PAYG issues.

Given the business has operated for 13 years, we are clearly dealing with a post CGT (Sept '85) asset and the 15-year retirement exemption does not apply.

Firstly, are there any capital losses in the company? If so then these should be offset first.

So, to be clear we are now dealing with the CGT small business concessions.

Given all the SBE CGT conditions have been met, you could apply the active asset (AA) concession (50% reduction) but the application of this illustrates the shortcomings of a company in these instances.

A trust would be effectively able to apply the active asset concession (50%) and then the individual concession (50% of the remaining balance) if the distribution was made to an individual.

This effectively deals with 75% of the capital gain.

In a company you can only apply the AA concession at company level – you then pay out this component of profit as an unfranked dividend then pay individual tax or deal with a Div7A issue.

For this reason, many people in this situation decide to apply the retirement exemption which is up to a lifetime limit of $500k per person.

If the significant individual is less than 55 years of age, then this must be paid into a complying super fund with no contributions tax.

If the individual is over 55 years of age, then there is no requirement that the capital gain be paid into a complying super fund – rather it can be accessed by the individual.

Question 3

Division 7A dividends

There is a small (family) private company and made a profit from the 2015/2016 and paid the company tax. But the company had not enough assets at that time and eventually made an item of "loan to director" on the FS. In the 2015 /2016, there was no dividend to shareholder (director).

This is the first case for me to deal with it. I have not done well at it.

For your reference, Loan to director: $100,000 for 2015/2016 and expected in $150,000 for 2016/2017.

I would like to know on how to manage with the "loan to director" for the correct company tax return.

Do I have to apply for the Division 7A for the company?

If applied, could you please let me know in detail how to apply for that including the minimum repayment and interest etc…?

Answer

First of all, what are the shareholders' marginal rates of tax?

It may be better to declare dividends if they have little or no taxable income.

This can be done by crediting their loan accounts – no actual payment needs to be made.

It sounds as of franking credits do exist.

You need to have a complying loan agreement in place and calculate interest on the loan which will depend on the timing of the debits to the loan account.

The first year the loan was advanced incurs no interest.

For your information the benchmark rates of interest are:

2015/16	5.45%
2016/17	5.40%
2017/18	5.30%

The formula in subsection 109E(6) of the ITAA 1936 will be of assistance.

We hope this helps.

Question 4

I have a quick question.

I have recently been engaged by a client for casual tutoring services. (18 hours /week).

I travel 3 days per week from my office to the University Campus. The distance is approx. 103klm. I intend using a log book and claim "cents/kilometre" method. A flat rate of $0.66/klm??

Could you advise if I am doing this correctly?

Answer

Yes, that is correct .... travel between two places of business is a tax deduction. It is fine to claim cents per kilometre but note the limit of 5,000 kilometres per financial year.

Under the existing arrangements you are travelling 618 kilometres a week. i.e. return trip 206 kms (assuming you return to the office) times three.

8 weeks of this will total 4,944 kilometres which will virtually expire the limit.

In view of this keeping a logbook is a good idea. A logbook must be kept for at least 12 consecutive weeks and is valid for:

5 years or until usage patterns change.

Clearly when this tutoring arrangement ceases usage patterns will have changed. Keeping an ongoing logbook means you may elect to claim a % of business use for the period these arrangements continue.

Keep your options open.

Question 5

My client is a NFP and they have salary packages for their Senior Executive Staff that are not as yet at the high-income threshold of $ 142,500. The salaries incorporate a cash component and then some packages have a non-cash but still monetary attributed value for the use of a Motor Vehicle, and others have a cash vehicle allowance valued at between $12,500 and $15,060 dependent upon position.

They pay the wages as per the Transitional Pay Equity order and they are under the Social, Community, Home Care and Disability Services Industry Award. Their staff specifically respondents to the Community Services Worker Levels.

The question is that overall, as a combined salary annually one would expect that it meets the no disadvantage test as an overall annual package, however when making such an assessment, would the Commission require or expect the cash component to be as per the specific Award level in the first instance?

I'm not used to seeing executive levels of wages in an award, but this award goes up to $ 102,710.40.

Most of their senior team are Level 6 and the highest level of that classification is $ 87,068.80 as an award rate. The salaries of the staff in question as a total package are: -

Staff Member A - $ 101,613.50

Staff Member B - $ 111,752.47

Staff Member C - $ 126,812.00

The reason the question has been raised is that while other staff are receiving CPI increases, where staff are employed under these executive salary package arrangements, there has been some movement over the past few years (2014 – 2017 the executive have had a movement / increase of between 2.19% to 4.35 % at CEO level) where the CPI increases over the same period have been 13.20%.

I know the non-disadvantage test takes into account many other factors however they are not working excessive hours or regular patterns of overtime. They have flexibility and autonomy to manage their own work schedules so there is no question that the hours expectation is unreasonable or outside of award terms.

So, to cut a long story short, if these salaries, as in the base salaries for the Executives, fall below the award level due to nominal CPI increases, does the Board need to increase the base cash component of the Executives to meet the award level or is the package overall considered to still be “over award”.

Answer

My preliminary view based on the information provided is that the “no disadvantage test” was part of the superseded Work Choices legislation and has been replaced with the Fair Work Act 2009 Cth Better Off Overall Test or BOOT which is substantially different.

Application of the BOOT may include the package items mentioned if they are clearly defined in a registered Enterprise Agreement or compliant Individual Flexibility Agreement, an employment contract may not meet these requirements unless drafted appropriately.

The first test applied under the national Employment Standards (NES) is that the employer is paying the minimum award wages and conditions and any over award payments are recorded appropriately, you can pay more than the award but not less than the award minimum rate, what instrument is used to record the pay and conditions depends upon the contract or agreement used and the terms contained in those agreements to meet the compliance standards...

Question 6

I am a subscriber to your excellent publication. I have CGT query I would appreciate your help on.

Husband and wife buy an investment property in about 2010 for $300K. It is purchased in H sole name and 100% financed. It is rented out full time.

H and W split up in 2017 and the investment property agreed to be worth $630K.

As part of the settlement which is formalised by consent orders made by the Family Court of Australia the investment property is transferred to W and becomes their principal place of residence after the settlement.

I understand in the above circumstances there is an automatic roll over of the CGT liability from transferor H to transferee W, assuming roll over conditions are met. I believe that would be the case here, when consent orders are made by the court. Is this correct and are there any other roll over conditions to be aware of?

So, if the above is correct the CGT liability transfers to W and becomes her responsibility when she sells at some future point.

Can you tell me how that future liability is calculated? Is it dependent on the length of time the W resides in the home as their principle place of residence? If that should be for only a very short period, say if W decides to sell within weeks of final orders, would the CGT liability she then assumes be nil, or virtually nil?

What happens to the CGT liability if after living in it as their principal place of residence for a time she decides to rent it out as an investment property and moves her principal place of residence?

I hope you can help me out with this.

Answer – (Part 1)

If you have a sound understanding of how rollover relief works, then the various scenarios you present can be readily worked out.

Roll-over relief means that the CGT liability is deferred until the transferee (W) eventually disposes of the asset and the transferee is taken to have acquired the asset at the same time the transferor (H) did.

So, in essence, W is deemed to have acquired this asset for $300k in 2010.

The scenarios you present are worked out on total days of ownership until sale with the exempt proportion being the days W actually resided in the dwelling.

In view of this your assumption that W could have a nil liability or very low CGT liability cannot be borne out.

We remind you that for at least 7 years this dwelling has been an investment property.

In the event W lives in the dwelling and then rents it out it may be possible for her to use the 6-year temporary absence, but this would depend on circumstances.

In particular that W had no other PPR.

Further to previous.......

The investment property was actually purchased in 2002 so it’s been an investment for 15 years.

W will take on a capital gain of $330K then as a result of the settlement transferring this property to her.

I agree that is hardly insignificant.

If she sold the property immediately after settlement what would be the estimated capital gains tax payable, assuming a low income and the tax-free threshold?

Is this gain reducible by the establishment costs at the time of purchase such as stamp duty and legals etc., or by interest payments and/or expenses over the 15 years?

Can you explain when the 50% discount to the CGT payable would apply?

Am I right in assuming the 50% discount on the capital gain would apply immediately after transfer and W does not have to live in the house as her PPR for any particular time (such as a year for example) to be eligible for that?

If she decided to sell, for example, a month after the final orders were made and the transfer completed she would still be entitled to the 50% discount with the CGT then being assessed (using the figures below) on $150,000.00?

Continued response ….

Essentially W is taken to have owned the property 100% from the date of purchase.

We do not have precise details for the property but let's make a crude estimate. On the basis W does not move in.

Sale		$630k
Less cost	$300k	
stamp duty	10.5	
legals	1.0	
Commission	15	(326.5)

So, you can see the capital gain is in the order of $300k but this does not take into account any possible renovations or holding costs – nor does it allow for any capital losses that W might have.

Also, some states have vendors' stamp duty.

If we apply the 50% discount, the situation is that taxable income will be in the order of $150k.

On the basis of their being no other income, we suggest the capital gains tax will be $46,132… say $46k and we would hope this was taken into account in the settlement.

If W plans to live in the house then as indicated earlier, it is less of an issue.

The 50% discount applies because it is a rollover – so if W sells quickly the 50% discount is still available.

The PPR exemption will only be available for the time lived there divided by the period of ownership.

So, we are dealing with a very small % in the event W lives there say for 3 months.

PLEASE NOTE THIS IS NOT ADVICE.

With the lack of detail, these calculations should NOT be relied upon. When you have the precise details, we suggest an accountant be engaged to the calcs.

Question 7

I have asked ATO a question regarding claiming Capital Works Deductions when I had rental property during last year. On the ATO website, it has written that you can claim 2.5% of the construction cost of the building but the advice which was given to me by ATO was not convincing. They have told me that I can only claim any improvement or construction which I have made during the rental period. They have told me that the construction cost should be part of the cost base and should be used when the property is sold i.e. part of calculating Capital Gains tax or loss.

I have not convinced with their advice because it is in contrast with the information they have written on the following link and the example they have given on that link.

https://www.ato.gov.au/General/Property/In-detail/Rental-properties/Rental-properties---claiming-capital-works-deductions/?anchor=Whatcanyouclaim#Whatcanyouclaim

On the above link, through the example, it clearly shows that I can claim the construction cost of the building which was happened before renting up the property.

My question from you. I have rented up my property most of the last year, Can I claim 2.5% of the construction cost of the building of the property? If yes, then can I add to the construction cost, the preliminary cost such as site work, surveying cost, planning cost, electrical and plumbing cost etc and the finishing costs such as paving, fencing, tiling, painting etc?

Answer

Depending on the date of construction the ATO may or may not be correct.

What is the date of original construction – if after July 1982 – in all likelihood there will be still be claims available.

As the construction costs will include some ineligible items and past costs will need to be determined, you must engage a quantity surveyor.

The expense will be easily recovered in the first year alone.

Question 8

We're subscribers and have a question regarding claiming GST input tax back on purchases of our vehicles used by directors for work and private use. We understand we can claim 100% back and yearly running expenses portioned according to the private usage rules. Had differing opinions on this and would appreciate your comments.

Answer

Below page references are to our annual publication…

You can claim business usage percentage of the GST back on purchase up to the motor vehicle (MV) depreciation cost limit which is currently $57,581. The business usage percentage is established by a complying logbook.

This means that irrespective of the cost of the MV, the maximum GST you can claim on a purchase is $57,581 divided by 11 i.e. $5,235. (page 50)

You claim 100% of the net expenses (also claiming back 100% of the GST on gross expenses) but as a company are subject to FBT under either the statutory formula or the log book method.

These methods determine the private use of the MV and accordingly the taxable value of the fringe benefits (pages 94-96)

Any unreimbursed expenses the employee incurs comes off the taxable value of the benefit

If you refer to the examples in our annual publication you will be able to determine the best course of action.

Question 9

I have a family trust to run the business. My accountant advised that I need to draw some wages out, so the business can contribute the guarantee super. Then I can also contribute personal super to the fund as well. Is it correct? I cannot contribute super without drawing any wages.

Answer

Your accountant may be just attempting to formalise things if your super arrangements have been set up that way.

That is the normal way of doing things for those in small business. It may well be that your Accountant wants to formalise some salary/super arrangement for budgeting and planning.

However there have been changes from 1 July 2017.

It is possible for you personally to make tax deductible contributions into super up to the maximum of $25,000 per year.

This would be $25k less any employer contributions. So, it is possible for you to receive an annual trust distribution and make contributions into super.

Talk to your accountant again.

Question 10

We are providing a service to a Singapore based company which does not have an Australian enterprise.

The service includes - Collecting empty gas containers from an Australian Port and transport them back to our yard for storage.

When required we transport the containers to a plant for filling then deliver back to our storage yard before taking them to wharf for export.

Are we correct in not charging GST for the service because…?

i) the non resident is not registered for GST

ii) The non resident does not have an Australian enterprise

iii) The sale (service) is not connected to Australia.

Answer

You are supplying transportation and storage facilities – there is no doubt that these are supplies in connection with Australia.

It is clear that you are not the exporter of the goods.

So, on the face of it these are supplies on which you may charge GST.

There is really only one basis on which you could argue the supply was GST free.

This is a supply that is constituted by the repair, renovation, goods modification, or treatment of goods from outside Australia whose destination is overseas.

We reviewed relevant rulings and section 38-355-5 and 38-355A. This states transportation, loading and handling of goods during the course of international transport is GST free. .

On this basis there is an argument that the supplies are GST free but we would recommend you seek a private ruling.

Leigh's Corner

ARTICLE NO.38 -

THE WORK HEALTH & SAFETY AND OTHER LEGISLATION AMENDMENTS ACT (QLD) 2017

THE IMPACT ON YOU AND YOUR QUEENSLAND BUSINESS

In August 2017 the Work Health & Safety and Other Legislation Amendments Bill (Bill) was tabled in the Queensland Parliament. The reason given for this Bill arose from a review on concerns of how safety is regarded as well as concerns on the effectiveness of the Work Health & Safety Act 2011.

This Bill was essentially a reaction to fatalities at Dreamworld and Eagle Farm Racecourse – in particular, concerns about the regulation of public safety and the effectiveness of the current WHS Legislation.

On the 12th October 2017 this Bill passed and became the Work Health & Safety and Other Legislation Amendments Act (QLD) 2017 (Act). This amends the Work Health & Safety Act 2011 (WHS Act) – the Electrical Safety Act 2002 (ES Act) – and the Safety in Recreational Waters Act 2011 (SRWA Act).

KEY CHANGES – WHO DOES IT AFFECT AND HOW?

The provisions of the Act include:

- Creates a new criminal offence – Industrial Manslaughter
  It was found that a **specific** offence was needed to deal with WHS failures causing fatalities, as well as dealing with public expectations following a fatality and to provide a deterrent effect
- Establishes an independent office for WHS Prosecutions
- Places restriction on the availability of enforceable undertakings

- Reintroducing the role of the Work Health & Safety Officer
- Restores the status of Codes of Practice
- Increases support for Health & Safety Representatives.

COMMENCEMENT OF AMENDMENTS

NEW CRIMINAL OFFENCE – INDUSTRIAL MANSLAUGHTER

A PCBU or senior officer commits an offence if:

- A worker dies in the course of carrying out his duties (or is injured, but later dies)
- The PCBU / Senior Officer's conduct causes, or substantially contributes, to the death of the worker
- This person is negligent in respect of causing the death of the worker

The exceptions are Volunteers, but **NOT** senior officers of unincorporated associations. Individuals acting with corporate authority can be criminally liable if that person's conduct substantially contributes to a fatality.

Prior to the passing of the Bill an amendment was made to expressly note that Section 23 of the Criminal Code **does not** apply as a defence to industrial manslaughter. Section 23 of the Criminal Code provides that a person cannot be criminally liable if there was no intention or motive. All that is required for a charge of industrial manslaughter to be brought is that the person's conduct causes the death and that the person is negligent about causing the death of the worker by that conduct.

MAXIMUM PENALTY – 20 YEARS IMPRISONMENT (INDIVIDUAL) - UP TO $10 MILLION IN PENALTY (CORPORATE BODY)

INDEPENDENT STATUTORY OFFICE FOR WHS PROSECUTIONS

The new statutory WHS prosecutions office will operate like the DPP – headed by a Prosecutor – who must follow DPP guidelines when deciding when to initiate prosecution.

Inspectors may still take proceedings for Category 3 offences with the authority of the Prosecutor. The current referral process to the DPP for indictable offences remains in place.

The functions of the WHS Prosecution Office include:

- Conducting and defending proceedings under the Act before a court or tribunal
- Advising WHSQ on matters relating to the Act
- Any other function specified under the Act or other Act

Impact of Change:

- There are concerns that there may no longer be any express obligation to consider whether there is a reasonable prospect of conviction in deciding to prosecute
- It seems to be a significant move away from national Harmonisation of Compliance and Enforcement – this Act relates to Qld only
- The independent Prosecution Office may assist in mitigating impact on strained inspector relationships.

REINTRODUCING THE ROLE OF THE WORKPLACE HEALTH & SAFETY OFFICER

Commencement Date – 1 July 2018

The reintroduction of the role of Workplace Health & Safety Officers (WHSO) is not mandatory. A PCBU may appoint a person who must hold a Certificate of Authority issued by Work Health & Safety Qld.

The appointment of a WHSO is considered in assessing evidence of compliance with the Act by a PCBU. The Bill does not contain other requirements that a WHSO taking on the role must also do.

Impact of Change:

- It is up to a PCBU to assess the utility or appropriateness of appointing a WHSO
- An appointed WHSO does not bear liability – the role of WHSO is designed to assist with compliance with WHS legislation
- The appointment of a PCBU does not affect the duties and obligations of a PCBU under WHS obligations
- Appointment may be used as evidence of compliance under WHS obligations

RESTRICTING THE AVAILABILITY OF ENFORCEABLE UNDERTAKINGS (EU)

This Act now expands the prohibition on accepting enforceable undertakings for a Category 1 offence – the exclusion applies to all officers involved in a fatality. Prior to harmonisation, WHSQ made it clear that an EU would not be accepted in the case of a fatality. However, the Act removes any discretion or ambiguity on this issue.

Review of the changes makes it seem unnecessary – previously, WHSQ already had the discretion to reject an EU application.

RESTORING THE STATUS OF CODES OF PRACTICE – 1 July 2018

Under this Act, the Codes of Practice will operate as a minimum standard – to be reviewed every 5 years to ensure the content remains relevant. Codes of Practice provide a good guide but not the detail required to ensure compliance.

Safety measures contained in Codes of Practice must be followed unless the PCBU can demonstrate they are providing a standard of health and safety that is at least equivalent to the standards under the relevant Code.

This Act clarifies the status of Codes of Practice by restoring the previous requirements from the 1995 WHS Act. The Codes provide clear enforcement action by inspectors where a minimum standard has failed to be reached.

However, Codes may also be used as evidence that a PCBU has complied with their safety obligations.

HEALTH & SAFETY REPRESENTATIVES – 1 July 2018

As a result of the review the Act's amendments include:

- **Reinstating repealed provisions requiring PCBU to provide WHSQ with list of HSR and deputy HSRs**
- **Mandating training for HSTs within six months of being elected with refresher training every 3 years**
- **Requiring PCBU to provide WHSQ with a copy of all PINs issued by HSR**

Currently, training for HSRs is discretionary – mandatory training will impose increased financial and practical obligations on PCBUs. There will be greater regulatory burdens imposed on a PCBU regarding exchange of information.

It is common for HSRs to be associated with unions – these changes may result in more activity which may be difficult to manage.

RIGHT OF ENTRY

Amendment of S171 – clarifies scope / availability of inspector's powers on entering a workplace or reviewing a document. An inspector can enter and request documents, even from head office location. The inspector does not have to be on site at Head Office to effectively request such documents.

Revises S70 (1) – a PCBU may only refuse access to information if such information "confidential commercial information".

Right of Entry - empowers inspectors that have been asked to assist in right of entry disputes to determine whether permit holder has a valid right of entry. In these circumstances an inspector can direct a PCBU to allow permit holder to enter premises. Where State WHS law allows a HSR to invite a union official onsite to assist them, the union official must hold a valid right of entry permit.

OTHER AMENDMENTS IN THE ACT – DATE YET TO BE FIXED

- The transfer of jurisdiction for issue resolution from the Queensland Civil and Administrative Tribunal (QCAT) to the Queensland Industrial Relations Commission (QIRC)
- Establishing the office of the WHS Prosecutor
- Expanding the powers of inspectors to assist in resolving disputes

NO INDUSTRIAL MANSLAUGHTER FOR THE MINING INDUSTRY AT THIS STAGE

Whilst the Government is committed to protecting workers in mines, quarries, on oil and gas rigs and people working with explosives, it will not move to introduce further amendments to the mining industry until consultation occurs with the resources industry.

Please note that this is general advice for information only and any application of legislation and/or Industrial Relations or contractual requirements may require professional advice to suit your individual circumstances.

If you have question for Leigh's team send us an email .... info@bo2.com.au

Bonus Issue

2017 SUPERANNUATION (WEALTH ACCUMULATION TIPS)

WHAT'S NEW IN 2017/18?

- New Australian Financial complaints authority
- Superannuation fund mergers – extended tax relief
- Housing affordability measure: reduced barriers to downsizing – contributing proceeds into super
- Housing affordability measure: first home super saver scheme.
- Regarding
  - Last year's changes we outline how these have played out
    - Higher SMSF penalties
    - SMSF borrowings to count towards $1.6 million balance cap
    - Stricter rules for non-arms length transactions
- We also include five new case studies.

1. New Australian Financial Complaints Authority

From 1.7.2018, the Superannuation Complaints Tribunal (SCT), the Financial Ombudsman Service (FOS) and the Credit and Investments Ombudsman (CIO), which deal with disputes regarding superannuation, banking, finance, insurance and trustee services, and financial services, respectively, will be replaced by a single external dispute resolution body, the Australian Financial Complaints Authority (AFCA). This follows a review of the current external dispute resolution framework.

The AFCA will be supervised by ASIC and all Australian Financial Services licensees will be required to be members. While decisions of the AFCA will be final and binding on all members, the new regime will refer back to the relevant financial organisation or superannuation trustee for resolution by means of internal dispute resolution.

To allow existing matters to be cleared, the SCT, FOS and CIO will keep operating until 1.7.2020.

2. Superannuation fund mergers – extended tax relief

The tax relief available for merging superannuation fund has been extended until 1.7. 2020. The relief allows superannuation funds to transfer capital and revenue losses to the successor fund, and to defer tax implications on gains and losses where there is a merger. This is intended to encourage consolidation of funds as it removes adverse tax consequences as a deterrent to mergers.

3. Incentive for over-65s to downsize by permitting extra super contributions

From 1.7.2018, Australians aged 65 years or over will be able to contribute the proceeds of a house sale (up to $300,000 for an individual, or $600,000 for a couple) without having to satisfy a work test, and without having to worry about the annual $100,000 non-concessional contributions cap. In addition, individuals with a total superannuation balance of more than $1.6 million will still be able to make a superannuation contribution under this downsizing policy.

4. Superannuation measures

- **Introduction of the First Home Super Saver Scheme**

From 1.7.2017, eligible individuals can make voluntary superannuation contributions of up to $15,000 a year, and up to $30,000 in total, which can be saved for the purposes of buying a first home. The contributions are treated as concessional (before-tax) contributions and taxed at 15%. Withdrawals (which include earnings) are permitted from 1 July 2018, and will be taxed at the person's marginal tax rate less a 30% tax offset. Alternatively, an individual can make non-concessional (after-tax) contributions, and such contributions are not taxed when withdrawn from the super fund.

On 7.9.2017 legislation relating to the First Home Super Saver Scheme and downsizing the family home was introduced into parliament.

5. SMSF borrowings to count towards $1.6 million transfer balance cap, and $1.6 million total superannuation balance

From 1.7.2017, the outstanding balance of an LRBA will be included in a member's annual total superannuation balance and the repayment of the principal and interest from a member's accumulation account will be recorded as a credit in the member's transfer balance account.

6. Higher SMSF penalties from 2017/2018 year

The size of administrative penalties has increased from July 2017 for SMSFs doing the wrong thing.

7. Non-arm's length transactions subject to stricter rules

From 1.7.2018, SMSFs using related party transactions on non-commercial terms aimed at increasing super savings will need to take into account expenses that normally apply to a commercial transaction when assessing whether the transaction is on a commercial basis.

SUPERANNUATION REFORM: INTRODUCING A $1.6 MILLION TRANSFER BALANCE CAP

The Government has introduced a $1.6 million cap on the total amount of superannuation savings that can be transferred from a concessionally-taxed 'accumulation account' to a tax-free 'retirement account.'

From 1.7.2017 there has been a $1.6 million cap on the total amount of superannuation that can be transferred into a tax-free retirement account.

- The cap will index in $100,000 increments in line with the consumer price index, just as the Age Pension assets threshold does.
- Superannuation savings accumulated in excess of the cap can remain in an accumulation superannuation account, where the earnings will be taxed at 15 per cent.
- A proportionate method which measures the percentage of the cap previously utilised will determine how much cap space an individual has available at any single point in time.
- For example, if an individual has previously used up 75 per cent of their cap they will have access to 25 per cent of the current (Indexed) cap.
- Subsequent fluctuations in retirement accounts due to earnings growth or pension payments are not considered when calculating cap space.

Consequences for breach

Individuals who breach the cap will be required to remove the excess capital from their retirement phase account and are liable to pay tax on the notional earnings attributable to the excess capital. The amount removed from the retirement phase can be transferred into an accumulation account, where the earnings will be concessionally taxed at 15 per cent, or withdrawn from superannuation.

Those individuals already in retirement as at 1.7.2017 with balances in excess of $1.6 million were required to either:

- Transfer the excess back into an accumulation superannuation account; or
- Withdraw the excess amount from their superannuation.

Transitional arrangements applied for existing account holders.

Individuals can also apply to the Commissioner of Taxation to replenish their transfer balance cap space for anomalous situations that cause their retirement balance to be depleted, such as fraud, bankruptcy or family law splits.

Example – Jason

Jason is 60 and plans to retire during the 2017-18 financial year. Jason expects he will have an accumulated superannuation balance of less than $1.6 million. This measure does not affect Jason.

Example – Agnes

Agnes 62 retires on 1 November 2017. Her accumulated superannuation balance is $2 million.

Agnes can transfer $1.6 million into a retirement income account. The remaining $400,000 can remain in an accumulation account where earnings will be taxed at 15 per cent. Alternatively, Agnes may choose to remove this excess amount from superannuation.

While Agnes will not have the ability to make additional contributions into her retirement account, her balance will be allowed to fluctuate due to earnings growth or drawdown of pension payments.

$1.6 Million Transfer Balance Cap Common Questions and Answers

Does the cap limit how much I can hold in my retirement phase account? What happens if my retirement account grows in excess of $1.6 million?

Answer- The cap only limits the amount you can transfer into a retirement phase account it does not apply to the balance on that account.

Your balance can grow above $1.6 million in your retirement phase account. The cap does not apply to this subsequent growth.

Once my retirement phase account balance falls below $1.6 million, can I transfer more?

Answer- An individual can transfer more into a retirement phase account only if they have not previously exceeded the cap. The amount of the cap space an individual has available will be determined by the proportionate method which measures the percentage of the cap previously utilised.

If, for example, an individual transfers the full $1.6 million into a retirement phase account which subsequently decreases the individual will not be able to transfer any more into the retirement phase as they have utilised 100 per cent of their cap space.

If an individual transfers $800,000 into a retirement phase account, they will have utilised 50 per cent of the cap space. If the cap is later indexed to, for example, $1.7 million, they will be able to transfer an additional 50 per cent of the indexed cap, being $850,000.

What happens if I make a transfer in excess of the cap after 1 July 2017?

Answer- If an individual transfers amounts into a retirement phase account in excess of the cap they will be required to remove the excess (including notional earnings on the excess capital). If they choose not to, their fund will be required to remove the excess on their behalf.

These amounts can be transferred back into an accumulation account, where the earnings on the excess will be taxed concessionally at 15 per cent. Alternatively, the excess can be withdrawn from superannuation.

Individuals will be subject to a 15 per cent tax on the notional earnings.

What happens if I am already retired before 1.7.2017 and have a retirement phase balance in excess of $1.6 million?

Answer- Individuals already in retirement with retirement phase balances in excess of the cap at 1.7.2017 will be required to either:

- Withdraw these excess amounts from superannuation; or
- Transfer these excess amounts back into an accumulation account.

The earnings on funds in an accumulation account will be taxed at the 15 per cent concessional tax rate.

Transitional arrangements will apply for those above $1.6 million but below $1.7 million – the Australian Taxation Office will issue a warning letter advising the individual they have 60 days to remedy the breach. If they comply, no further penalty is applicable.

Those who do not comply with the warning letter and those with balances above $1.7 million will be subject to the consequences of their fund removing the excess and a tax on notional earnings on the excess capital.

What if I retired before 1.7.2017 and transferred less than $1.6 million at that time, but my balance has grown to $2 million through investment returns?

Answer- You will still need to comply with the cap. If your balance prior to 1.7.2017 is in excess of $1.6 million, you will need to remove the excess amount from your retirement account.

How will this cap apply to defined benefit pensions?

Answer- Different arrangements involving changes to the taxation of defined benefit pension payments will be adopted to achieve broadly commensurate treatment with accumulation schemes.

Defined benefit pensions will not be required to be commuted and rolled-back if they are valued at over $1.6 million. Rather, defined benefit pension payments over $100,000 per annum will be subject to additional taxation to broadly replicate the effect of the $1.6 million transfer balance cap.

How will this cap apply to non-commutable pensions (commenced prior to 1 July 2017)?

Answer- Non-commutable pensions that commenced prior to 1.7.2017 will be treated the same as defined benefit pensions.

How will this cap apply to non-defined benefit, non-account-based income streams (started after 1 July 2017)?

Answer- Products such as lifetime annuities, market-linked pensions and annuities and term/life expectancy pensions and annuities will be valued using their purchase price.

How will this cap apply to future 'innovative' income stream products?

Answer- These products will be valued using their purchase price.

If a product is purchased with instalments during the accumulation phase or deferred from the point of purchase, it will be valued using an existing method requiring actuarial certification.

Collective defined contribution scheme pensions will be valued at the amount of the collective pool of fund assets attributed to the member on the day the pension commences and certified by an actuary.

Do transition to retirement income streams count towards the transfer balance cap?

Answer- No. As transition to retirement income streams (TRIS) will no longer receive an earnings tax exemption from 1.7.2017 they do not count towards the transfer balance cap.

Can I still split my retirement phase interests to purchase or diversify my retirement income streams?

Answer- Yes. Once you have transferred your superannuation income streams to the retirement phase, they are not counted again towards your transfer balance cap.

To achieve this outcome, your transfer balance account will receive a 'debit' equal to the value of the amount commuted. This amount, plus any unused cap space, may then be used to purchase a new income stream or retirement product.

To ensure the integrity of this approach, you will no longer be able to use partial commutations to satisfy minimum drawdown requirements.

If you choose to commute your income streams (either in part or in full) you will receive a debit equal to the value of the commutation.

Do I need to pay tax on income from my retirement account? Or on the amounts that I withdraw from my accumulation phase account?

Answer- No. The Government has not changed the taxation treatment of amounts drawn down from superannuation accumulation accounts by people who have reached their preservation age. Superannuation benefits paid, either as an income stream or as a lump sum, from a funded source (that is, one in which taxes have been paid on contributions and earnings such as in an accumulation scheme or a funded Defined Benefit scheme), are generally tax-free for people aged 60 and over.

The earnings on amounts in an accumulation phase account are taxed at the concessional 15 per cent tax rate. Withdrawn funds are not taxed, providing the individual has reached age 60. There is no minimum (or maximum) drawdown requirements from accumulation accounts.

Will the $1.6 million transfer balance cap be indexed?

Answer- Yes. The cap will index in $100,000 increments in line with the consumer price index, just as the Age Pension assets threshold does.

Do structured settlements or personal injury payouts count towards the cap?

Answer- These amounts will not count towards an individual's transfer balance cap. This will ensure that individuals can continue to access these arrangements which support them in meeting their healthcare and living costs.

For couples where one spouse either does not have a superannuation account or has a low balance in their account/s can they have a joint $3.2 million cap?

Answer- The transfer balance cap is an individual cap. Each individual can transfer $1.6 million into their retirement phase account/s from their accumulation account/s.

An individual with more than $1.6 million in the retirement phase will need to either transfer the excess to an accumulation account where earnings will be taxed, or withdraw the excess from the superannuation system. Subject to the contribution caps, excess amounts withdrawn could be contributed to their spouse's account.

In the superannuation system, and most areas of tax, people are taxed and treated as individuals not as families or households.

REFORMING THE TAXATION OF CONCESSIONAL CONTRIBUTIONS

The Government has lowered the annual cap on concessional (pre-tax) contributions to $25,000 and reduced the income threshold above which high income individuals are required to pay 30 per cent tax on their concessional superannuation contributions – commonly referred to as the Division 293 threshold – to $250,000 per annum.

From 1 July 2017, the Government has lowered the annual concessional contributions cap to $25,000 for all individuals. The cap will index in line with wages growth.

Until this time the existing concessional caps ($30,000 for those aged under 50 and $35,000 for those people aged 50 and over) applied.

Additionally, from 1.7.2017, the Government reduced the income threshold, above which individuals will be required to pay an additional 15 per cent tax on their concessional contributions, from $300,000 to $250,000 per annum.

The additional tax is imposed on the whole amount of the contributions, up to the concessional cap, if your salary and wages are above the threshold. Otherwise, the additional tax is only imposed on the portion of the contribution that takes you over the threshold.

The additional tax is imposed on the whole amount of the contributions, up to the concessional cap, if your salary and wages are above the threshold. Otherwise, the additional tax is only imposed on the portion of the contribution that takes you over the threshold.

To be liable for a total of 30 per cent tax, a person needs to have at least $250,000 in combined income and concessional superannuation contributions.

- In 2017-18 approximately one per cent of fund members are expected to pay additional contributions tax as a result of this measure.
- These individuals will have an average taxable income of $270,000 and an average superannuation balance of $550,000.

Existing processes for the administration of the concessional contributions caps and the imposition of the additional 15 per cent tax on contributions will be maintained, although some processes will be streamlined.

Example – Madeline

In 2017-18, Madeline earns $260,000 in salary and wages. In the same year she has concessional superannuation contributions of $30,000.

Madeline's fund will pay 15 per cent tax on these contributions. Madeline will pay an additional 15 per cent tax on the $25,000 of concessional contributions resulting in these amounts effectively being taxed at 30 per cent.

The $5,000 of contributions in excess of the cap will be included in Madeline's assessable income and taxed at her marginal rate. Madeline pays $1,600 income tax on her excess contribution.

SUPERANNUATION REFORM: ANNUAL NON- CONCESSIONAL CONTRIBUTIONS CAP

From 1 July 2017, the Government has lowered the annual non-concessional (post-tax) contributions cap to $100,000 and introduced a new constraint such that individuals with a balance of $1.6 million or more will no longer be eligible to make non-concessional contributions.

Individuals under age 65 will be eligible to bring forward 3 years of non-concessional contributions. The new annual cap with the eligibility threshold replaces the lifetime $500,000 non-concessional contributions cap announced in the 2016-17 Budget.

This will better target tax concessions to ensure that the superannuation system is equitable and sustainable, ensuring those who have saved well in excess of what is required to be self-sufficient in retirement are not able to continue to access further concessional tax treatment. It will also provide flexibility recognising that non-concessional contributions are often made in large lump sums.

From 1 July 2017, the Government has lowered the annual non-concessional contributions cap to $100,000, which is four times the annual concessional contribution cap, with a three year bring forward ($300,000) for those aged under 65. Where an individual's total superannuation balance is $1.6 million or more they are longer be eligible to make non-concessional contributions.

The $1.6 million eligibility threshold is based on an individual's balance as at 30 June the previous year. This means if the individual's balance at the start of the financial year (the contribution year) is $1.6 million or more they will not be able to make any further non-concessional contributions. Individuals with balances close to $1.6 million are only able to bring forward the annual cap amount for the number of years that would take their balance to $1.6 million.

Transitional arrangements applied. If an individual did not fully used their non-concessional bring forward before 1 July 2017, the remaining bring forward amount was reassessed on 1.7.2017 to reflect the new annual caps.

As was formerly the case, individuals aged between 65 and 74 are eligible to make annual non-concessional contributions of $100,000 if they meet the work test (that is they work 40 hours within a 30-day period each income year), but are be able to access the bring forward of contributions.

The annual cap is linked to indexation of the concessional contributions caps. The $1.6 million eligibility threshold will be indexed as per the transfer balance cap.

Non-concessional contributions to defined benefit schemes and constitutionally protected funds will also be subject to the revised caps.

Eligibility Threshold

Individuals are eligible to make non-concessional contributions where their total superannuation balance is less than $1.6 million. Where their balance is close to $1.6 million, they will only be able to make a contribution in that year and access the bring forward of future years contributions that would take their balance to $1.6 million.

Superannuation Balance	Contribution and bring forward available
Less than $1.3 million	3 years ($300,000)
$1.3 - <$1.4 million	3 years ($300,000)
$1.4 - <$1.5 million	2 years ($200,00)
$1.5 - <$1.6 million	1 year ($100,000)
$1.6 million	Nil

Transitional Arrangements

Where an individual has made a non-concessional contribution in 2015-16 or 2016-17 and that triggers the bring forward, but has not fully used their bring forward before 1 July 2017, transitional arrangements will apply so that the amount of bring forward available will reflect the reduced annual contribution caps. Where the non-concessional contribution bring forward was triggered in 2015-16, the transitional cap will be $460,000 (the annual cap of $180,000 from 2015-16 and 2016-17 and the $100,000 cap in 2017-18). If the bring forward was triggered in 2016-17, the transitional cap will be $380,000 (the annual cap of $180,000 in 2016-17 and $100,000 cap in 2017-18 and 2018-19).

<table>
<tr><th>2015-16</th><th>2016-17</th><th>2017-18</th><th>2018-19</th><th>2019-20</th></tr>
<tr><td colspan="2">More than $460,000</td><td>Nil</td><td>End of transition period $100,000 or 3 year bring forward</td><td>-</td></tr>
<tr><td>More than $180,000 but less than $460,000</td><td colspan="2">Cannot exceed $460,000 from 2015-16 to 2017-18</td><td>End of transition period $100,000 or 3 year bring forward</td><td>-</td></tr>
<tr><td>-</td><td>More than $380,000</td><td>Nil</td><td>Nil</td><td>End of transition period $100,000 or 3 year bring forward</td></tr>
<tr><td>-</td><td>More than $180,000 but less than $380,000</td><td colspan="2">Cannot exceed $380,000 from 2016-17 to 2018-19</td><td>End of transition period $100,000 or 3 year bring forward</td></tr>
</table>

For example, if you made a contribution to access the bring-forward in 2016-17, the bring-forward amount available in later years is $380,000 (see example 1 and 2). If you made a contribution in 2015-16, the bring-forward amount will be $460,000 (see example 3).

	2016-17	2015-16	2017-18	2018-19	2019-20
1	$200,000		$180,000	Nil	$100,000
2	$200,000		$90,000	$90,000	$100,000
3	$200,000	$200,000	$60,000	$100,000	Nil

Example - Kylie

Kylie's superannuation balance is $500,000. She sells an investment property and makes a non-concessional contribution to her superannuation of $200,000 in October 2017. As Kylie has triggered her bring forward, she would be able to make a further non-concessional contribution of $100,000 in 2018-19. In 2020-21 her non-concessional contributions caps would reset, and she could make further contributions from then.

Example - Molly

Molly is 40 and has a superannuation balance of $200,000. In September 2016, she receives an inheritance of $250,000, which she puts into her superannuation. This triggers her three year bring forward. From 1 July 2017, as the cap has been lowered, Molly would be able to make further non-concessional contributions of up to $130,000, taking her to the new bring forward amount of $380,000. Molly makes a non-concessional contribution of $110,000 in 2017-18 and $20,000 in 2018-19. She can then access the new bring forward from 2019-20 and contribute up to $300,000 in non-concessional contributions.

Example - Eamon

Eamon has a total superannuation balance of $1.45 million. He can make a non-concessional contribution in 2017-18 of $200,000. He cannot access the full three year bring forward as this would take his balance over $1.6 million. Eamon would also not be able to make any further non-concessional contributions.

Example - Gary

Gary is a 72-year-old retiree who works around 40 hours in September every year and has a superannuation balance of $450,000. As Gary meets the work test, he can make a non-concessional contribution of $100,000 in2017-18. However, as Gary is aged over 65 he cannot access the three year bring forward.

SUPPORTING AUSTRALIANS TO SAVE FOR THEIR RETIREMENT BY INTRODUCING THE LOW INCOME SUPERANNUATION TAX OFFSET

The Government has introduced a Low Income Superannuation Tax Offset to replace the Low Income Superannuation Contribution.

This will provide continued support for the accumulation of superannuation for low income earners and ensure they do not pay more tax on their superannuation contributions than on their take-home pay.

The issue

The superannuation system is designed to encourage Australians to save for their retirement. This is why superannuation is taxed at a lower rate than income outside of superannuation. However, for low income earners, the 15 per cent tax on superannuation contributions means they pay more tax on their superannuation contributions than on their other income.

The details

From 1 July 2017, the Government has introduced the Low Income Superannuation Tax Offset.

Those with an adjusted taxable income up to $37,000 will receive a refund into their superannuation account of the tax paid on their concessional superannuation contributions, up to a cap of $500.

In effect, this means that most low income earners will pay no tax on their superannuation contributions.

Low income earners, who are disproportionately women, will benefit from the Low Income Superannuation Tax Offset. This is important because women, on average, had lower superannuation balances than men, despite having higher life expectancies. It is expected that in 2017-18 around 3.1 million people (almost two-thirds of whom are women) will benefit from the Low Income Superannuation Tax Offset.

The Low Income Superannuation Tax Offset will effectively avoid the situation in which low income earners would pay more tax on savings placed into superannuation than on income earned outside of superannuation.

Implementation

The Australian Taxation Office will determine a person's eligibility for the Low Income Superannuation Tax Offset and this will be paid into the person's superannuation account.

Example - Katherine

In the 2017-18 financial year Katherine worked part-time as a nurse and earnt $35,000. Her employer made superannuation contributions of $3,325 on her behalf.

Katherine is eligible for the Low Income Superannuation Tax Offset. She receives $498.75 of Low Income Superannuation Tax Offset in her account.

Katherine would have received the same amount of Low Income Superannuation Contribution.

EXTENDING THE SPOUSE TAX OFFSET

The Government also extended the current spouse tax offset to assist more couples to support each other in saving for retirement.

This will better target superannuation tax concessions to low income earners and people with interrupted work patterns.

From 1 July 2017, the Government has extended the eligibility rules for claiming the tax offset for superannuation contributions partners make to their low income spouses.

The current 18 per cent tax offset of up to $540 will be available for any individual, whether married or de facto, contributing to a recipient spouse whose income is up to $37,000. This is an increase from $10,800. As was formerly the case, the offset is gradually reduced for income above this level and completely phases out at income above $40,000.

No tax offset is available when the spouse receiving the contribution has exceeded their non-concessional contributions cap.

There are no changes to the aged based contribution rules. The spouse receiving the contribution must be under age 70, and meet a work test if aged 65 to 69.

Example – Anne and Terry

Anne earns $37,500 per year. Her husband Terry wishes to make a superannuation contribution on Anne's behalf.

Under the former arrangements, Terry would not be eligible for a tax offset as Anne's income is too high. There is no incentive for Terry to make a contribution on behalf of Anne.

Under the new arrangements, Terry would be eligible to receive a tax offset.

As Anne earns more than $37,000 per year, Terry will not receive the maximum tax offset of $540. Instead, the offset is calculated as 18 per cent of the lesser of:

- $3,000 reduced by every dollar over $37,000 that Ann earns, or
- The value of spouse contributions.

For example, Terry makes $3,000 of contributions and Anne earns $500 over the $37,000 threshold. Terry receives a tax offset of $450: 18 per cent of $2,500 as this is less than the value of the spouse contributions ($3,000).

If Anne were to earn more than $40,000 there would be no tax offset.

People with superannuation balances of $500,000 or less will be able to accrue additional concessional cap amounts from 1 July 2018.

Individuals will be able to access their unused concessional contributions cap space on a rolling basis for a period of five years. Amounts that have not been used after five years will expire.

This increased flexibility will make it easier for people with varying capacity to save and for those with interrupted work patterns, to save for retirement and benefit from the tax concessions to the same extent as those with regular income.

Individuals aged 65 to 74 who meet the work test are now able to access these arrangements.

Example - Cassandra

Cassandra is a 46-year-old earning $100,000 per year. She has a superannuation balance of $400,000.

In 2018-19, Cassandra has total concessional superannuation contributions of $10,000.

In 2019-20, Cassandra has the ability to contribute $40,000 into superannuation of which $25,000 is the amount allowed under the annual concessional cap and $15,000 is her unused amount from 2018-19 which has been carried forward.

The full $40,000 will be taxed at 15 per cent in the superannuation fund. Prior to the changes, her amounts in excess of the annual cap would have been subject to tax at her marginal rate, resulting in an additional $3,600 tax liability.

Catch-Up Contributions Common Questions and Answers

How much is carried forward?

Answer- Only amounts of unused concessional cap space from 1 July 2018 will be carried forward. For example, if in 2018-19 an individual contributes $15,000 they will carry forward $10,000.

I didn't work in 2015 or 2016 and didn't make contributions. Can I carry forward those unused amounts?

Answer- No, only unused amounts from 1 July 2018 onwards can be carried forward.

How will I know how much I can contribute in any single year?

Answer- Members seeking to utilise the carry forward should keep track of their available amounts by reviewing prior year concessional contributions compared to the relative cap in that year. This information can generally be found on the member contribution statements funds provided to members each year.

What happens if I contribute more than I am allowed?

Answer- An individual can make concessional contributions in a single year up to the value of the concessional cap and any carried forward amount they have available. Any amounts in excess of this will be taxed at the individual's marginal tax rates.

Is there a limit on how long amounts can be carried forward?

Answer- Carried forward amounts expire if they remain unused after five years.

How do I know if my balance is below $500,000 so I can make additional contributions?

Answer- In the first instance you should contact your fund(s) to determine the value of your total superannuation balance.

In addition, the A.T.O currently displays the last reported balances for all of an individual's superannuation accounts through the MyGov online service.

How is my superannuation balance calculated?

Answer- An individual's superannuation balance will be calculated as the sum of their accumulation phase superannuation interests (i.e. those not in the retirement phase) and the balance as reported for the transfer balance cap. Their balance will also include any roll-over amounts that haven't already been counted elsewhere.

IMPROVING ACCESS TO CONCESSIONAL CONTRIBUTIONS

The Government has improved the flexibility of the superannuation system by allowing more people to make tax-deductible personal superannuation contributions to an eligible fund up to their concessional contributions cap.

The issue

Formerly, an income tax deduction for personal superannuation contributions was only available to people who earn less than 10 per cent of their income from salary or wages.

This means those who earnt a small amount, but more than 10 per cent, of their income in salary and wages were formerly restricted from receiving tax concessions on their retirement savings. It similarly means that some employees were prevented from fully accessing the tax concessions simply because their employer did not allow them to make pre-tax contributions through salary sacrifice.

This change allows all individuals under 75 to make concessional superannuation contributions up to the concessional cap (including those aged 65 to 74 who meet the work test). Individuals who are partially self-employed and partially wage and salary earners – for example contractors – and individuals whose employers do not offer salary sacrifice arrangements, will benefit from these changes.

The details

The Government now allows all Australians under 75 who make personal contributions (including those aged 65 to 74 who meet the work test) to claim an income tax deduction for any personal superannuation contribution into an eligible superannuation fund. These amounts count towards the individual's concessional contributions cap, and be subject to 15 per cent contributions tax.

To access the tax deduction, individuals will lodge a notice of their intention to claim the deduction with their superannuation fund or retirement savings provider. Generally, this notice will need to be lodged before they lodge their income tax return. Individuals can choose how much of their contributions to deduct.

Certain untaxed and defined benefit superannuation funds will be prescribed, meaning members will not be eligible to claim a deduction for contributions to these funds. Instead, if a member wishes to claim a deduction, they may choose to make their contribution to another eligible superannuation fund.

Example – Chris

Chris is 31 and decides to start his own online cricket merchandise business. While he gets his business up and running he continues working part-time in an accounting firm where he earns $10,000. In his first year his business earns him $80,000. Of his $90,000 income he would like to contribute $15,000 to his superannuation account.

Under former arrangements, Chris would not be eligible to claim a tax deduction for any personal contributions. While his employer allows him to salary sacrifice into superannuation, he is limited to the $10,000 he earns in salary and wages.

Under the new arrangement, Chris will qualify for a tax deduction for any personal contributions that he makes (up to his concessional cap).

Chris makes a $15,000 personal contribution and notifies his superannuation fund that he intends to claim a deduction. He includes the tax deduction as part of his tax return.

ENHANCING CHOICE IN RETIREMENT INCOME PRODUCTS

From 1 July 2017, the Government has extended the tax exemption on earnings in the retirement phase to products such as deferred lifetime annuities and group self-annuitisation products.

These products seek to provide individuals with income throughout their retirement regardless of how long they live.

This will allow providers to offer a wider range of retirement income products which will provide more flexibility and choice for Australian retirees, and help them to better manage consumption and risk in retirement, particularly longevity risk, wherein people outlive their savings.

In addition, the Government will consult on how these new products are treated under the Age Pension means test.

Example - Emma

Emma is a 65-year-old retiree who currently draws down her account-based superannuation pension at the minimum rates to ensure her superannuation savings do not run out.

Emma is energetic and healthy and would like to have the confidence that her superannuation savings will last throughout her retirement. However, as deferred and pooled income stream products do not qualify for the retirement phase earnings tax exemption these products are not widely offered in the market.

Extending the retirement phase tax exemption on earnings to a wider range of products will provide Emma with more choice and flexibility. This will allow her to maintain a higher standard of living in retirement and give her peace of mind knowing she will always have a guaranteed income stream.

IMPROVE INTEGRITY OF TRANSITION TO RETIREMENT INCOME STREAMS

The Government has removed the tax exempt status of income from assets supporting transition to retirement income streams.

Individuals are no longer allowed to treat certain superannuation income stream payments as lump sums for tax minimisation purposes.

Transition to retirement income streams were introduced in 2005 to provide limited access to superannuation for people wanting to move towards retirement by reducing their working hours and using their superannuation to supplement their income.

People can commence a transition to retirement income stream between preservation age (currently 56)1 and age 65.

Individuals in receipt of transition to retirement income streams enjoy tax-free earnings on their superannuation assets. Recipients are also able to reduce their tax liability by salary sacrificing their income (that would otherwise be taxed at their marginal tax rate) into superannuation and instead taking a superannuation income stream at a concessional tax rate.

The Productivity Commission has recently found that transition to retirement income streams have increasingly been used by people for tax minimisation purposes without any reduction in work hours.

The details

To ensure access to transition to retirement income streams is primarily for the purpose of substituting work income rather than tax minimisation, the tax exempt status of income from assets supporting transition to retirement income streams was be removed from 1 July 2017.

Earnings from assets supporting transition to retirement income streams are now be taxed concessionally at 15 per cent. This change applies irrespective of when the transition to retirement income stream commenced.

Reducing the tax concessional nature of transition to retirement income streams ensures they are fit for purpose and not primarily accessed for tax minimisation purposes.

Further, individuals are no longer be able to treat certain superannuation income stream payment as lump sums for tax purposes, which currently makes them tax-free up to the low rate cap ($200,000).

1 An individual’s preservation age depends upon their date of birth

Date of Birth	Preservation age (years)
Before 1 July 1960	55
1 July 1960 – 30 June 1961	56
1 July 1961 – 30 June 1962	57
1 July 1962 – 30 June 1963	58
1 July 1963 – 30 June 1964	59
After 30 June 1964	60

Example – Sebastian

Sebastian is 57 years old, earns $80,000 and has $500,000 in his superannuation account. He pays income tax on his salary and his fund pays $4,500 tax on his $30,000 earnings.

Sebastian decides to reduce his work hours to spend more time with his grandchildren. He reduces his working hours by 25 per cent and has a corresponding reduction in his earnings to $60,000.

He commences a transition to retirement income stream worth $20,000 per year so that he can maintain his lifestyle while working reduced hours.

Currently, Sebastian pays income tax, but his fund pays nothing on the earnings from his pool of superannuation savings.

Under the Government's changes while the earnings on Sebastian's superannuation assets will no longer be tax free they will still be taxed concessionally (at 15 per cent). He will still have more disposable income than without a transition to retirement income stream. This ensures he has sufficient money to maintain his lifestyle, even with reduced work hours.

Social Security Income Test

The Social Security Income Test for individuals in receipt of a defined benefit pension from superannuation was amended with effect from 1 January 2016 to exclude a maximum of 10% of actual pension payments drawn from assessment.

Social Security Assets Test

From 1 January 2017, the social security assets free area thresholds were increased from $202,000 to $250,000 for single home owners and from $286,500 to $375,000 for couples who own a home. The thresholds for pensioners who do not own their own home is now $200,000 higher than those above i.e. $450,000 (single) and $575,000 (couple).

In addition, the 'taper rate' for assets in excess of the thresholds was increased from $1.50 for each $1,000 of assets over the relevant threshold to $3 (i.e. this is the rate that applied prior to September 2007).

In order to qualify for a part pension, the maximum value of assets that can be held (excluding the home) has been reduced:

- From up to $1.15 million (couples) to $823,000; and
- From up to $775,000 (singles) to $547,000

For pensioners who do not own their own home, both the lower and higher threshold was increased by $200,000.

In effect, the full pension is now payable to more people (because more will fall within these limits) but it has also phased out more quickly, meaning fewer people now receive a part pension.

The below tables summarise the changes.

Lower Threshold (full pension)	Current	Proposed
Single homeowner	$202,000	$250,000
Single non-homeowner	$348,500	$450,000
Couple homeowner	$286,500	$375,000
Couple non-homeowner	$433,000	$575,000

Cut-off threshold (no pension payable)	Current	Proposed
Single homeowner	$775,000	$547,000
Single non-homeowner	$922,000	$747,000
Couple homeowner	$1,151,500	$823,000
Couple non-homeowner	$1,298,000	$1,023,000

The sweetener in all of this is that at least wealthier retirees have still held on to the Commonwealth Seniors Health Card or Health Care Card.

SUPERANNUATION CONTRIBUTIONS

Contributions Caps

Concessional Contributions Caps

Age at 30 June prior to financial year commencing	2016-17	2017-18
49 or more	$35,000 [1]	$25,000 [1]
Less than 49	$30,000 [2]	$25,000 [2]

1. Unindexed
2. General concessional cap is indexed to average weekly ordinary time earnings (AWOTE) in $5,000 increments

Note: *Concessional contributions which exceed the concessional cap also count towards the non-concessional cap unless withdrawn (see the following section). Concessional contributions include: Superannuation guarantee (SG) contributions including SG shortfall, industrial award and certified agreement contributions, additional employer contributions, salary sacrifice contributions, personal deductible contributions.*

Tax treatment of Concessional Contributions

Concessional Contributions		
	Within Cap	**Exceeding cap**
Concessional contributions that (along with income 1) do not exceed $250,000	15% (levied on fund)	15% (levied on fund) plus MTR less 15% offset 2 (levied on individual)
Concessional contributions that (along with income 1) exceed $300,000 ($250,000 from 1.07.2017)	15% (levied on fund) plus 15% (Div. 293 tax levied on individual)	15% (levied on fund) plus MTR less 15% offset 2 (levied on individual)

1. Income includes taxable income (including the net amount on which family trust distribution tax is paid); reportable fringe benefits and total net investment loss, less the taxable component of lump sum super member benefits within the low rate cap ($195,000 for 2016-17).
2. Excess concessional contributions made from 1 July 2013 are effectively taxed at a client's marginal tax rate (plus an excess concessional contributions tax interest charge). Clients also have the ability to withdraw up to 85% of their excess concessional contributions, in which case they will no longer count toward the non-concessional contributions cap.

Non-Concessional Contributions

Age as at 1 July 2016	Annual cap	Tax rate
Under 65	$180,000, or $540,000 over a three-year period under bring forward rule.	Nil (49% where contributions exceed cap)
65-74 (work test met)	$180,000	

Note: *Non-concessional contributions include: personal contributions for which no tax deduction is claimed, spouse contributions and the non-taxable portion of a foreign pension transfer. Proceeds from the small business 15-year exemption and capital gains subject to the small business C.G.T retirement exemption and contributed to super (C.G.T contributions) generally will not be taxed by the fund, but will be treated as non-concessional contributions unless they count towards and do not exceed the C.G.T cap. C.G.T contributions above the C.G.T cap will count towards the non-concessional cap.*

Note, changes from 1 July 2017 outlined above.

TAX RATES FOR SUPERANNUATION ENTITIES ALIGNED TO THE TOP MARGINAL TAX RATE

Until 30 June 2017 this rate was increased to 47% to reflect the budget repair levy.

The following acts have been passed:

- Superannuation (Departing Australia Superannuation Payments Tax) Amendment (Temporary Budget Repair Levy) Act 2014
- Superannuation (Excess Non-Concessional Contributions Tax) Amendment (Temporary Budget Repair Levy) Act 2014
- Superannuation (Excess Untaxed Roll-over Amounts Tax) Amendment (Temporary Budget Repair Levy) Act 2014

Type of Income	Rate before 1 July 2014	Rate after 1 July 2014	Rate after July 2017
Income of non-complying super funds	45%	47%	45%
Non-arm's length income	45%	47%	45%
No-TFN-quoted contributions	46.5%	49%	47%

The May 2017 Budget did not extend the two percent levy.

EARLY RELEASE SCHEMES

There are now new penalties for unlawful payments from superannuation funds.

These relate to the promotion of early release schemes designed to obtain the early illegal release of superannuation benefits.

CONTRACTORS AND THE SUPERANNUATION GUARANTEE CHARGE

Note that contractors are generally considered employees for SG purposes if the contract is wholly or principally for labour.

In Superannuation Guarantee Ruling SGR 2005/1, the A.T.O indicates that a contract will be considered wholly and principally for labour (and the contractor is therefore an employee for SG purposes) where the contractor:

- is remunerated (wholly or principally) for their labour or skills, and
- must perform the contractual work personally (i.e. there is no right of delegation), and
- is not paid to achieve a result.

For further guidance on the treatment of contractors, refer to SGR 2005/1, available at www.law.ato.gov.au. The A.T.O has also developed an employee/contractor decision tool, available at www.ato.gov.au

WORKERS AND SUPERANNUATION

In August 2017, the government announced a further package of reforms to give the Australian Taxation Office (A.T.O) near real-time visibility over superannuation guarantee (SG) compliance by employers.

Along with increased funding, the package also builds on legislation already announced to close a legal loophole used by unscrupulous employers to short-change employees who make salary-sacrifice contributions to their superannuation.

The package includes measures to:

- Require superannuation funds to report contributions received more frequently. At least monthly, to the A.T.O. This will enable the A.T.O to identify non-compliance and take prompt action;
- Bring payroll reporting into the 21st century through the rollout of Single Touch Payroll (STP). Employers with 20 or more employees will transition to STP from 1 July 2018 with smaller employers coming on board from 1 July 2017. This will reduce the regulatory burden reporting of taxation and superannuation obligations;
- Improve the effectiveness of the A.T.O's recovery powers, including strengthening director penalty notices and use of security bonds for high-risk employers, to ensure that unpaid superannuation is better collected by the A.T.O and paid to employee's super accounts; and
- Given the A.T.O the ability to seek court-ordered penalties in the most egregious cases of non-payment, including employers who are repeatedly caught but fail to pay superannuation guarantee liabilities.

The package reflects the key recommendations in the Final Report of the SG Cross-Agency Working Group released on 14 July 2017.

ESTATE PLANNING AND RECENT SUPERANNUATION CHANGES

We have covered in detail the changes that have applied since 1.7.2017. In general, these changes have reduced the tax benefits found within super.

Consequently, it would appear that testamentary trusts have come to the fore as a vehicle to preserve family wealth for future generations.

Testamentary trusts are established in Wills and are activated when the will maker dies. As well as providing asset protection for vulnerable beneficiaries, testamentary discretionary trusts are known for their tax advantages.

Testamentary discretionary trusts provide considerable flexibility to minimise tax by reason of:

- The ability to make distributions to minors using the full adult taxpayer tax-free threshold currently $18,200 and then lower marginal rates of tax.
- The flexibility to decide which person among a class of beneficiaries should receive a distribution and the amount of that distribution with a focus on beneficiaries in the lowest marginal tax rates;
- Flexibility in determining which beneficiaries receive different classes of income e.g. capital gains, franked dividends again with a view to minimise tax.

SELF-MANAGED SUPERANNUATION FUNDS - WHAT EXPENSES ARE DEDUCTIBLE IN A (SMSF)?

Common fund expenses

When considering if it is appropriate for the fund to pay a particular expense, it is important to ensure the payment is in accordance with a properly formulated investment strategy, allowed under your trust deed and the super laws.

Operating expenses

Operating expenses that are incurred by an SMSF are mostly deductible under the general deduction provision (section 8-1 of the Income Tax Assessment Act 1997 (ITAA 1997)) except to the extent they relate to the gaining of non-assessable income (such as exempt current pension income) or are capital in nature.

The following are examples of the types of operating expenses that are typically deductible under the general deduction provision:

Management and administration fees

These are costs associated with the daily running of the fund such as preparing trustees' minutes, stationery and postage fees. Such costs must be apportioned if the fund earns both assessable and non-assessable income.

No apportionment is necessary for costs that are wholly incurred in collecting and processing contributions (for example, costs associated with obtaining an electronic service address (alias) to meet the data standards requirements).

An SMSF may incur other more specific management and administrative costs in running a fund that are dealt with under other headings.

Audit fees

An SMSF is required by the super laws to ensure that an approved SMSF auditor is appointed to give the trustee(s) a report of the operations of the entity for each year of income.

Audit expenditure that relates to meeting obligations under super laws is deductible but must be apportioned if the SMSF gains or produces both assessable and non-assessable income.

The administrative penalties that can be levied on a trustee under the super laws are not deductible to the fund as they are incurred by the trustee of the fund (or director of the corporate trustee) and must not be paid or reimbursed from the assets of the SMSF.

ASIC annual fee

ASIC charges an annual fee to special purpose companies; whose sole purpose is to act as a trustee of a regulated superannuation fund. While the vast majority of SMSFs operate under an individual trustee structure, many choose to use a corporate trustee arrangement.

Corporate trustees pay an initial ASIC registration fee but are also required to pay an annual fee. The ASIC annual fee is payable where an SMSF has a corporate trustee and, as such, this expense is deductible by the fund.

Investment-related expenses

The exact nature of the investment-related expenses is critical in determining deductibility. Examples of deductible investment related expenses include:

- interest expenses
- ongoing management fees or retainers paid to investment advisers
- costs of servicing and managing an investment portfolio such as bank fees, rental property expenses, brokerage fees
- the cost of advice to change the mix of investments, whether by the original or a new investment adviser provided it does not amount to a new financial plan.

If the investment related advice covers other matters, or relates in part to investments that do not produce assessable income, only a proportion of the fee is deductible.

Example 1 - The trustees of an SMSF, approach a financial adviser with the aim to put in place a long term financial strategy incorporating the need to have sufficient liquidity to pay super income stream benefits, lump sum payments and continue with investments that in the long term will provide super or death benefits for the members.

A fee paid to an investment adviser to draw up an investment strategy for the fund in these circumstances would be a capital outlay even if some of the existing investments are maintained as part of the plan. This is because the fee is for advice that relates to drawing up a new investment strategy. The character of the outgoing is not altered because the existing investments fit in with this new strategy. It is still an outgoing of capital.

Example 2 - The trustees of a fund decide to seek the advice of an investment adviser as to what (as specified in the fund's investment strategy are permitted by the governing rules of the fund) listed securities they should invest in.

The cost of the advice as to what listed securities to invest in is deductible as it is part of the ongoing maintenance of the current investment strategy and not part of a new investment strategy or plan.

Tax-related expenses

A specific deduction is allowable under section 25-5 of the ITAA 1997 for an expense incurred in managing a fund's tax affairs or complying with a Commonwealth tax law obligation imposed on the trustee.

You cannot deduct capital expenditure under this section. However, an expense is not a capital expense merely because the tax affair relates to a matter of a capital nature. For example, the cost of applying for a private ruling on whether you can depreciate an item of property may be deductible under this section.

The following are examples of deductible tax-related expenses incurred in managing an SMSF's income tax affairs and complying with income tax laws:

- costs relating to the preparation and lodgment of the SMSF's annual return including the preparation of financial statements
- actuarial costs incurred in satisfying income tax obligations, for example to determine the amount of tax exempt income (or exempt current pension income).

Statutory fees and levies

An SMSF is also liable to pay a supervisory levy under the *Superannuation (Self Managed Superannuation Funds) Supervisory Levy Imposition Act 1991*. The levy is a flat amount and is also deductible under section 25-5 of the ITAA 1997.

With respect to the costs incurred in preparing and lodging the SMSF's annual return, a possible interpretation of the relevant laws would necessitate apportionment between income tax and super-related expenses. Given that the return is one approved form covering both income tax and super law requirements, we are of the view that it would be an impost for SMSFs to have to apportion between the two types of expenses and have taken the approach of allowing in full as a deduction the expenses incurred in preparing and lodging the return.

A tax-related expense does not need to be apportioned on account of an SMSF deriving both non-assessable and assessable income, unless the expenditure is in relation to audit fees paid by the fund. Audit expenditure that relates to meeting obligations under super laws is deductible under the general deduction provisions and must be apportioned if the SMSF gains or produces both assessable and non-assessable income. Refer to Audit fees.

Legal expenses

Some legal expenses are covered by specific deduction provisions (for example, legal expenses incurred in complying with income tax obligations under section 25-5 of the ITAA 1997).

Legal expenses that are not covered by a specific provision are generally deductible under the general deduction provision. This is excepted to the extent that they are incurred in deriving non-assessable income or are capital, private or domestic in nature.

***Example:* Borrowing expenses – capital in nature**

An SMSF engages a legal firm to set up a trust to hold an asset that the fund intends to acquire under a limited recourse borrowing arrangement (LRBA) (as required by the super law).

Section 25-25 of the ITAA 1997 is a specific deduction provision which enables a taxpayer to deduct expenses incurred for borrowing money to the extent that the money is used for the purposes of producing assessable income.

Borrowing expenses which can generally be claimed under this specific provision include:

- loan establishment fees
- obtaining relevant valuations
- costs of documenting guarantees required by the lender
- lender's mortgage insurance
- fees for property and title search fees, costs for preparing and filing mortgage documents, etc.

The costs in establishing a trust for an LRBA are not considered to be borrowing expenses because they are incurred for establishing the arrangement through which the borrowing occurs, not for the borrowing itself. Therefore, the SMSF cannot claim a deduction for its legal expenses in setting up the trust under section 25-25 of the ITAA 1997.

Also, the SMSF cannot claim these costs as a deduction under the general deduction provision because they are capital in nature.

Trust deed amendments

Trust deed amendment costs incurred in establishing a trust, executing a new deed for an existing fund and amending a deed to enlarge or significantly alter the scope of the trust's activities are generally not deductible as they are capital in nature.

Trust deed amendments required to facilitate the ongoing operations of the super fund are generally deductible under the general deduction provision. If a fund amends a trust deed to keep it up to date with changes to the super law, the expense in doing this will be deductible under the general deduction provision. This is unless the amendment results in enduring changes to the SMSF's structure or function or creates a new asset.

Example 1 - An SMSF is a two-member fund comprising a couple who are also the individual trustees of the fund. One of the members dies at a time before either member has retired. The surviving member decides to continue the SMSF with a corporate trustee of which they are the sole director.

The fund incurs legal expenses of $1,000 to amend the trust deed so the corporate trustee can be appointed. Making changes to the trust deed of the SMSF to permit appointment of a corporate trustee relates to the structure of the SMSF and the expenses are capital in nature. The legal expenses incurred in amending the trust deed are not deductible under section 8-1 of the ITAA 1997.

Example 2 - The trustees of an SMSF decide that the fund's trust deed is out of date. It refers to super law provisions which have been repealed and to contact addresses for the trustees that are no longer current.

The trustees decide to engage a legal firm to update the deed. The firm charges $500. As the changes to the trust deed are an ordinary incident of the day to day running of the fund and are not capital in nature, the $500 charged by the legal firm is deductible to the fund.

Example 3 - The trustees of an SMSF decide that, as part of a properly formulated investment strategy, they will borrow money to purchase an apartment under an LRBA.

The trust deed of the SMSF, as it currently stands, does not permit the trustees to borrow money. The trustees engage a legal firm to amend the trust deed so that it permits the trustees to borrow money under an LRBA.

The costs incurred in engaging the law firm to change the trust deed are not deductible. This is because the addition of borrowing powers is an enduring change to the function of the SMSF.

Death, total and permanent disability, terminal illness and income protection insurance premiums

A specific deduction is available to the trustee of a complying super fund in relation to insurance premiums paid for insurance policies that are for current or contingent liabilities to provide death or disability benefits.

A deduction is available in relation to the insurance premiums to provide for the following types of death or disability benefits:

- super death benefits
- terminal medical condition benefits
- disability super benefits
- benefits provided due to temporary inability to engage in gainful employment for a specified period.

The amount that can be claimed by the fund is set out in the relevant income tax laws and there is no apportionment required for these expenses between those that relate to assessable and non-assessable income.

Collectables and artwork

Special rules apply to SMSF investments in collectable and personal use assets, such as artwork. These rules were introduced on 1 July 2011 to cover aspects such as storage and insurance.

Insurance costs for artwork and other collectables are deductible to the SMSF provided the items are insured in the name of the fund within seven days of acquisition and the receipt for the expense is in the name of the fund. You can't, for example, insure the item as part of a trustee's home and contents insurance.

Storage costs for artwork and collectables are also deductible to the fund provided that these items are stored in accordance to the Superannuation Industry (Supervisions) Regulations 1994. In particular, the trustees must make and keep records of the reasons for deciding where to store the item number.

When you can claim...

As a general rule, the trustee can claim the fund's expenses in the year the trustee incurs them. However, deductions for the decline in value of certain depreciating assets (such as plant and equipment) are claimed over the effective life of the asset rather than at the time the trustee incurs the expenditure.

Trustees should retain any invoices and/or receipts evidencing the fund's expenses. Invoices and receipts must be in the name of the SMSF, and wherever possible, the expense should be paid directly from the fund's bank account.

Deductibility of expenses

As a general rule, the deductibility of expenses incurred by a super fund is determined under section 8-1 of the Income Tax Assessment Act 1997 (also known as the general deduction provision) unless a specific deduction provision applies, for example, tax related expenses deductible under section 25-5 of the ITAA 1997.

If an expense is deductible under the general deduction provision, and the fund has both accumulation and pension members, the expense may need to be apportioned to determine the amount that the fund can deduct.

If an expense is deductible under one of the specific deduction provisions, then the wording of that provision will indicate whether the expense must be apportioned and on what basis.

Specific deductions

The following is a list of some of the specific deduction provisions that apply to SMSFs. Some can be claimed in full while others will require apportionment:

- Expenditure incurred to the extent that it is for managing the tax affairs of the SMSF or complying with an obligation imposed on the SMSF which relates to its tax affairs, for example the SMSF Supervisory Levy (section 25-5 of the ITAA 1997)
- Death, total and permanent disability, terminal illness and income protection premiums to the extent specified in the relevant law (section 295-465 of the ITAA 1997)

General deductions

In the absence of a specific deduction provision, and subject to exclusions discussed below, a loss or outgoing incurred by a super fund is deductible under section 8-1 of the ITAA 1997 (the general deduction provision) to the extent that:

– it is incurred in gaining or producing assessable income

– it is necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.

Expenses that are an ordinary incident of the operations of the SMSF that gain or produce its assessable income fall under this general deduction provision (unless a specific provision could also apply and is more appropriate in the circumstances).This can include expenses such as:

– management and administration fees

– audit fees

– subscriptions and attending seminars

– ongoing investment related expenses.

Is a super fund carrying on a business?

The investment activities of SMSF trustees must be conducted in accordance with the trustees' duty to preserve and grow the fund for its members. In that context, the investment activities of most SMSFs would not be characterised as activities in carrying on a business (as compared to similar activities conducted by a trading company).

However, the activities of some SMSFs in dealing in shares and other investments may amount to the carrying on of a business having regard to factors such as the scale of the activities and the manner in which they are conducted.

Exclusions

Under the general deduction provision, an SMSF cannot deduct a loss or outgoing to the extent that:

– it is a loss or outgoing of capital, or of a capital nature

– it is a loss or outgoing of a private or domestic nature

– it is incurred in relation to gaining or producing income of the fund that is not assessable income such as exempt current pension income

– the income tax laws prevent the fund from deducting it.

You cannot claim more than one deduction for the same expenditure. If two or more tax provisions allow you deductions for the same expenditure you can deduct only under the most appropriate provision.

Apportionment

General deductions

Where an expense is deductible under the general deduction, the expenditure is deductible only to the extent to which it is incurred in producing the fund's assessable income.

Distinctly identified part

Where the expense is incurred partly in gaining or producing assessable income and partly in gaining or producing non-assessable income such as exempt current pension income, and the fund can identify a distinct and severable part devoted to gaining or producing assessable income, then this is the part that the fund should claim as a deduction under the general deduction provision.

Example- The trustee of the SMSF appoints a property managing company in respect of three investment properties held by the fund. One of those properties is a holiday rental home and is managed by the company's regional office. The holiday rental property is also a segregated current pension asset of the fund and so the income derived from this asset is exempt. The company charges the fund $2,000 for its services but the invoice identifies $500 of that amount as being the costs incurred by the regional office for managing the holiday rental home.

The amount of $500 can be distinctly identified as a cost incurred in gaining the fund's exempt income while the remaining $1,500 can be distinctly identified as a cost incurred in gaining the fund's assessable income. The fund may claim the amount of expenditure which relates to the assessable income, being $1,500, as a deduction.

Estimating an expense

Many expenses cannot be divided into distinct and severable parts in this way. For example, paying an approved SMSF auditor to provide an annual report for the fund is an expense that does not relate in any particular way to either the fund's assessable or non-assessable income.

In such a case, the fund has to estimate, in a fair and reasonable way, how much of that expense was incurred in producing the fund's assessable income.

It is not possible to prescribe a single method for apportioning expenditure of a super fund and Taxation Ruling TR 93/17 provides a number of examples, providing guidance on what the Commissioner may accept as a method producing a fair and reasonable outcome.

Example 1 - The trustee of the SMSF incurs audit expenses of $1,500 for providing the SMSF with a report in accordance with its regulatory obligations. The fund has unsegregated assets and therefore obtains an actuarial certificate each year to determine the exempt current pension income of the fund.

The percentage specified by the actuary in the relevant year is that 70% of the value of fund assets is held to support current pension liabilities. The remaining 30% of the value of fund assets is held to provide for assessable income in the fund.

The trustee decides that this percentage is a fair and reasonable method for apportioning the audit expenses. The expenditure that can be claimed as having been incurred in gaining assessable income is $450 (being $1,500 x 30%).

Example 2 - The trustee of the SMSF incurs audit expenses of $1,500 for providing the SMSF with a report in accordance with its regulatory obligations. The SMSF earned $60,000 in assessable and $100,000 in non-assessable income.

The trustees of the fund have decided that the following method is a fair and reasonable way to apportion these expenses:

- Audit expense x assessable income/total income
- $1,500 x $60,000/$160,000.

This results in an amount of $562 for audit expense that can be claimed as a deduction by the SMSF.

Example 3 - An SMSF has both pension and accumulation members and does not segregate its assets.

The trustees obtain an actuary's certificate to determine the proportion of the fund's income that is exempt current pension income. The actuary certifies that 40% of the fund's income is exempt.

The trustees of an SMSF engage an accounting firm to undertake the administrative functions of the fund. The accounting firm charges a fixed upfront fee of $1,500 per annum for the following services:

- preparation of annual financial statements
- preparation and lodgment of the fund's annual return
- arranging for the annual audit of the fund
- preparing member benefits statements
- preparation of reports on the fund's investments.

The fixed fee of $1,500 is not calculated according to the cost of each particular service. The expense therefore cannot be easily divided into distinct and severable parts.

The trustees decide that it would be fair and reasonable to use the exempt income percentage as certified on the actuary's certificate to determine the proportion of the accountant's fee that is deductible. This is calculated as follows:

- Expense x assessable income %
- $1,500 x (100% - 40%) = $900

This results in a portion of $900 of the $1,500 fee that can be claimed as a deduction by the SMSF.

Capital versus revenue expenses

An expense that is incurred in establishing or making enduring changes to a super fund's structure or function is capital in nature and is not deductible under the general deduction provision. For example, the costs of establishing an SMSF are capital in nature. An expense incurred in acquiring a capital asset is also usually capital in nature. Refer to the example under trust deed amendments.

On the other hand, an expense that is incurred in making changes to the internal organisation or day to day running of the fund is not considered to be capital in nature provided such changes do not result in an advantage of a lasting character. If a super fund is carrying on a business, it may be entitled to deduct certain capital expenses under the specific deduction provision, section 40-880 of the ITAA 1997. Refer to Is a super fund carrying on a business?

Section 8-1 of the ITAA 1997 does not allow a deduction for expenditure of a capital, private or domestic nature or expenditure incurred in gaining or producing exempt income.

Example - One of the members in a two-member fund with individual trustees dies and a decision is made once the death benefit has been paid from the fund to change the SMSF to a single member fund with a corporate trustee.

In addition to the usual fund expenses incurred in running the fund, the following additional expenses are incurred:

- legal expenses to amend the trust deed to change the fund to a single member fund with corporate trustee – $300
- Australian Securities and Investments Commission (ASIC) fees associated with setting up the corporate trustee.

The SMSF will not be able to claim either of these amounts. The legal expenses of $300 are of a capital nature as they are incurred in making enduring changes to the structure of the fund. ASIC fees incurred in setting up the corporate trustee are also capital in nature and, in any event, are not considered to be expenses incurred by the fund.

CORPORATE VERSUS INDIVIDUAL TRUSTEE

It is clear that A.S.I.C, the A.T.O and advisers generally prefer corporate trustees for a SMSF. The below table explains the reasons.

Continuous succession

A company has an indefinite lifespan, allowing succession to control more certain on death or incapacity. Timely action be taken on death to ensure the Trustee/Member rules are satisfied. A sole individual Trustee/Member SMSF – means there is no separation of legal and beneficial ownership. As such SMSF rules do not permit this.

Asset Protection

Companies have limited liability and provide some protection where a party sues the Trustee for damages. If an individual Trustee incurs any liability, their personal assets are also exposed.

Change in members

On admission or cessation of membership, that person becomes, or ceases to be, a director/shareholder of the company. Meaning, the title to all assets remains in the Company's name. When a member joins or leaves a fund, that person must become, or cease to be, an individual Trustee. As trust assets must be held in all Trustees names, the title to all assets must be transferred to the new Trustees.

Penalties

The administrative penalty regime only applies to a company once for each contravention. A penalty can be imposed on each individual trustee for each contravention. Thus, having two individual Trustees can double the administrative penalty that would otherwise apply to a corporate Trustee.

Sole member Fund

An SMSF can have one individual as both the sole member and the sole director. A sole member SMSF must still have two individual Trustees.

Estate planning

A company offers greater flexibility for estate planning, as the trustee does not change as a result of the death of a member. The death of a member means unwelcome administrative work at a time when people are grieving.

SUPER AND DIVORCE

Due to recent changes, dividing superannuation has become easier. Super splitting laws treat super as a different type of property which allows separating couples to value their super and split payments between them.

One important development is that the law includes de facto couples (including same sex couples) in this regime, except for those residing in Western Australia.

Depending on how much agreement there is between the parties, couples may:

- Enter into a formal agreement to split the member-spouse's super. A formal written agreement involves certificates confirming both parties have had formal legal advice. Once both agree there is no need to go to court.

- This becomes a binding document which the super fund trustee must act on, or
- Seek consent orders to split the super, or
- Seek a court order to split the super

While there is no legal requirement to obtain a valuation of the fund, it is sensible to do so, particularly in the case of defined benefit funds. The court is required to value the super interest of both parties if a court order is sought.

What the agreement must say

The laws state the superannuation agreement must specify:

- The base amount
- The method for calculating the base amount, and
- A percentage that is to apply to all splittable payments made in respect of the base amount.

Generally, only super accrued up to the time of separation is split and percentage shares used for super still in its growth phase (as opposed to the payment phase where amounts can be specified).

Where an agreement specifies a dollar amount, the non-working spouse is generally entitled to that amount adjusted for the performance of the fund.

The laws apply to a married, or formerly married couples who had not finalised settlement of their property arrangements by a court order under section 79 of the Family Law Act or an agreement approved by a court under section 87 of that Act, before the laws commenced on 28 December 2002, and

De facto couples, in most states and territories, whose relationship broke down on or after 1 March 2009 (and South Australian de facto couples, where their relationship broke down on or after 1 July 2010).

Points to Note...

- You cannot access the super until you reach a condition of release, such as retirement.
- The non-member spouse can specify where they would like their entitlement to be rolled over to.
- You require legal advice and a legally binding agreement for the trustee to be bound by its terms.

FAIRER TAXATION OF EXCESS CONCESSIONAL CONTRIBUTIONS

From 1 July 2013 onwards, excess concessional contributions are no longer subject to excess contribution tax.

The Government will tax excess concessional contributions at the individual's marginal tax rate, plus an interest charge (recognising that tax on excess concessional contributions is collected later than personal income tax).

The Government has also confirmed that individuals with income greater than $250,000 will be subject to a 30 per cent rate of tax on certain non-excessive concessional contributions rather than the 15 per cent rate.

This important change announced in the current reforms extends that relief to all concessional contributions, regardless of amount and when made.

The imposition of an additional interest charge on excess concessional contributions appears likely to curtail strategies for those on the highest marginal tax rate to deliberately make excess concessional contributions.

Currently, an individual on the 47 per cent marginal tax rate is subject to the same rate of tax on personal income as excess contributions, but benefits by a timing arbitrage on the later, due to the collection of PAYG income tax compared to the tax of excess concessional contributions. Additional interest charges would appear to remove this benefit.

Ceasing Pensions

A member in receipt of a pension who is feeling 'financially unstable' should consider rolling it back into accumulation mode. This will ensure their super interests are fully protected (subject to the claw back provisions) in the event they become bankrupt.

SELF MANAGED SUPER FUNDS CAN STILL INVEST IN COLLECTIBLES AND PERSONAL USE ASSETS

Self Managed Superannuation Funds (SMSF) will continue to be allowed to invest in collectibles and personal use assets like artwork or stamps, provided they are held in accordance with tightened legislative standards.

The Government has tightened the rules, so people can't claim they are, for example, 'collecting' high-end sports cars, paying tax and then actually driving around in those vehicles.

The new rules will ensure these investments do not give rise to a personal benefit for SMSF trustees, but rather are held for the purpose of providing retirement benefits.

SENIOR AUSTRALIANS AND SUPER

From 1 July 2013, the upper age limit for compulsory super was removed. This means no matter how old you are if you are working and eligible, you can still grow your super.

Government Co-Contribution

- ***Indexation of income thresholds paused***

  The Co-contribution thresholds are no longer frozen. The current income threshold to receive the maximum 100% co-contribution is $36,813 (2017-18). Once an individual's total income exceeds this threshold the co-contribution is reduced by 3.33 cents for every dollar over $36,813 and cuts out once you receive total income for more than $51,813.

Even with the above changes, the co-contribution remains an effective strategy to build Super savings for low to middle income workers.

TAXATION RULING TR2012/6

This ruling provides guidelines on issues relating to the deductibility of premiums paid by complying superannuation funds for insurance policies which provide total and permanent disability cover for members.

TAX TIP - ACCESSING TWO CONTRIBUTIONS CAP IN ONE INCOME YEAR

- Here we are dealing with excess contributions.
- This can easily happen given the contributions cap is only $25,000 for the 2018 income year.
- Mistakes are easily made when salary sacrificing a performance bonus at year ends when not taking into account statutory super (9.5%).
- Further those with multiple employers also run into this problem.
- In Interpretative Decision ID 2012/16 the A.T.O has confirmed that a contribution is counted towards the cap in the year in which it is **allocated.**

Essentially this means a Super Fund that receives an excess contribution for a member in...say June 2018 can defer allocating the contribution to the member up until 28th July 2018. In many instances this will overcome the problem. Always seek specialist advice before going down this path.

THE WITHDRAWAL AND RE-CONTRIBUTION STRATEGY IS STILL WORTHWHILE

This strategy aims to increase the tax free component of a superannuation sum by withdrawing the taxable component, then re-contributing this amount back into the Fund as a non-concessional contribution, and in so doing increase the tax free component of the members funds.

This was very popular prior to 30 June 2007 when the laws changed to make a pension paid from a super fund generally tax free to those aged over 60 years.

However, this strategy is still very important for those less than 60 as they will still pay some tax on their pension withdrawals or on lump sums above the thresholds (currently $170,000) on their taxable component.

There is also an estate planning issue for those over 60 given the ultimate recipient of a lump sum benefit is often a non-dependant, such as an adult child, for income tax purposes.

This is because non-dependants generally pay tax on the taxable component of a lump sum death benefit.

Also, potential future legislative changes cannot be ignored – it is always a good defensive strategy for superannuation interests to be "non- taxable".

THE RENEWED APPEAL OF PROPERTY

For many SMSF trustees still shell shocked from the G.F.C. share market meltdown, property is looking like a far more attractive prospect than shares – particularly now it is possible to borrow within an SMSF.

These borrowing rules potentially lift the biggest obstacle on SMSFs investing in property: the lack of sufficient cash to buy a property outright.

Most people buying investment property do so to fund their retirement. However, only a small minority buy property through their SMSF.

On average, a property held within super for 20 years will be 35 per cent more profitable than one held in an individual's own name. That is even though the set-up costs are higher, the tax benefits of margin lending are reduced – at least in the first two years – and annual interest costs are generally 1 percentage point higher for SMSF loans.

Those on highest marginal tax must earn $1.96 for every dollar of net profit they receive, whereas inside an SMSF only $1.18 must be earned.

Properties held in an SMSF attract just 15 per cent tax on rental income, instead of being taxed at the individual's marginal tax rate. If the property is held until the pension phase it can be sold with no capital gains tax incurred.

Although properties sold on their depreciation benefits may be less profitable in the short term because of the lower value of the tax deductions within the low tax environment of the SMSF, people in their 40's to 50's may consider using their SMSF to buy property to build strong and consistent growth in a tax effective environment. These matters need to be carefully considered and discussed with a reputable financial adviser.

However, a trustee should always consider the superannuation fund's investment strategy.

Subsection 52(2) (f) of the SIS Act requires a superannuation fund trustee to formulate an investment strategy:

(f) To formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the entity including, but not limited to, the following:

i. The risk involved in making, holding and realising, and the likely return from the entity's investments having regard to its objectives and its expected cash flow requirements;

ii. The composition of the entity's investments as a whole; including the extent to which the investments are diverse or involve the entity in being exposed to risks from inadequate diversification;

iii. The liquidity of the entity's investments having regard to its expected cash flow requirements;

iv. The ability of the entity to discharge the existing and prospective liabilities;

The above considerations are incorporated in the 'operating standards' contained in Regulation 4.09 of the SIS Regulations.

Normally the above requirements are contained in SMSF annual trustee minutes or embedded in the notes to the annual financial statements and therein the problem lies. Too often the investment strategy is viewed as only a compliance afterthought at the end of the financial year and after the investment decisions have been taken.

Although technically the letter of the law may have been adhered to, it should be noted the above investment standards are there to protect the fund members and their retirement savings.

Of course in SMSF's the trustees and the fund members are essentially one and the same. However, there is a real danger in a "get rich quick" mentality.

Really all SMSF Trustees should consider subsection 52(2)f of the SIS Act each time they make an investment decision and prepare a minute outlining the investment decision and how it complies with 52(2)f.

It is suggested this is a form of self discipline which if taken in the recent past by SMSF trustees could have saved them from some losses.

PERSONAL DEBT AND SUPERANNUATION

In general superannuation can't be accessed until genuine retirement. The A.T.O have recently issued a number of warnings about illegal early access schemes and has successfully prosecuted several trustees.

Recently a SMSF lost its complying status as a result of using superannuation monies to support a related business. The Administrative Appeals Tribunal upheld the A.T.O's decision to make a fund non-complying. The husband and wife trustees had difficulties in getting funding for their business and instead arranged for their SMSF to make loans to support the business. The loans were in breach of the 5 per cent in-house asset rule, which was reported by the fund's auditor. Although undertakings were made to repay the loans, this did not occur for a further two years.

There are, however, three situations where clients with debt difficulties may legitimately be able to use their superannuation prior to retirement:

1. Unrestricted non-preserved (UNP) monies

2. Severe financial hardship

3. Compassionate grounds

While legislation permits release of benefits under these conditions, not all superannuation funds will permit releases on all these conditions. Most public offer funds will permit release of UNP monies on groups specified by the Australian Prudential Regulation Authority (APRA). However, a significant number of funds do not allow severe financial hardship payments. The availability of these benefits in SMSFS will depend upon the terms of the fund's trust deed.

Unrestricted Non-Preserved Monies

It is worth reviewing clients' account balances to determine if they have any UNP monies. These may have arisen from voluntary contributions made prior to 1 July 1999, or from superannuation benefits rolled over from another fund where the rolled over amount has previously satisfied a condition of release.

Severe Financial Hardship

For clients aged below 55 years who wish to access their benefits on the grounds of severe financial hardship, there are two tests that must be met before a trustee is able to release a benefit. The client must:

- Be in receipt of a Commonwealth income support payment, and have been so continuously for the past 26 weeks (the objective test), and
- Satisfy the trustee that they are unable to meet reasonable and immediate family living expenses (the subjective test).

Compassionate Grounds

Preserved benefits and restricted non-preserved benefits may be released on specified compassionate grounds by APRA where a client does not have a financial capacity to meet:

- Medical expenses and associated costs in difficult circumstances for a fund member or family member
- To prevent foreclosure of a mortgage of the member's principal place of residence defined in the legislation as an amount in each 12-month period that does not exceed an amount equal to the sum of:
  - (i) Three months' repayments, and
  - (ii) 12 months' interest on the outstanding balance of the loan.

To apply to APRA, it is necessary to complete the relevant form available from the APRA website and to provide a written statement from the mortgagee that:

(a) Payment of an amount is overdue, and

(b) If the person fails to pay the amount, the mortgagee will:

(i) Foreclose the mortgage on the person's principal place of residence or

(ii) Exercise its express, or statutory, power of sale over the persons' principal place of residence.

The statement must also include information to calculate the amount of three months' repayments and 12 months' interest.

DEATH BENEFITS

- All lump sum death benefits paid to dependants are tax free.
- Lump sums paid to non-dependants will be taxed at 15% for taxable component – taxed element and 30% for the untaxed element. The tax free component is always tax free.
- Death Benefits can be paid to dependants in the form of lump sum and/or pension. Whereas non-dependants can only receive death benefits in lump sum.
- Special rules will apply to the taxation of pension death benefits paid to dependants depending upon the age of the deceased and beneficiary. If the deceased or beneficiary is age 60 or over, the pension death benefits with taxable component taxed element is tax free and the untaxed element is taxed at marginal tax rate less 10% tax offset. Where both the deceased and the beneficiary are under 60, the pension death benefits with taxable component – taxed element is taxed at marginal tax rate less 15% tax offset and the untaxed element is taxed at marginal tax rate without offset.

Payments Prior to Death

Consider a person over 60 who has:

- Assets in super and has met a condition of release
- Has no dependants
- Is terminally ill

In this instance consideration should be given to getting assets out of the super fund to avoid the taxes outlined above.

BASIC ESTATE PLANNING NEEDS

- Do you have a valid Will that is regularly reviewed?
- Have you considered a Power of Attorney where a person grants another person the power to make certain decisions on their behalf such as to buy or sell properties?
- Consideration should be given to an Enduring Power of Attorney that lets someone act on your behalf if you

lose the ability to make decisions for yourself. If you don't have one in place, in the unfortunate event of not having the "capacity" to maintain your affairs, control of your assets may pass to a government body such as The Office of the Protective Commissioner.

- Binding nominations are effective choices as to which beneficiaries receive your superannuation entitlements and in what proportions. Note if these nominations are not kept up-to-date, you could find your super money is distributed in the way you had not preferred.

You should have a financial plan that considers tax effectiveness. The rules that apply to different assets, such as the tax treatment of a family home compared to shares or investment property must be considered.

SALARY SACRIFICE - SUPERANNUATION CONTRIBUTION

Here we acknowledge the change in legislation from 1.7.2017 which allows individuals a personal tax deduction for superannuation contributions up to $25,000 per annual less any employer contributions.

Salary sacrifice still remains valid given its enforced savings nature throughout the year towards the end of a financial year, many people want to contribute to super but simply do not have any funds available.

The Consequences Of Salary Sacrifice Contributions Are As Follows:

- The salary sacrifice contribution is subject to 15% contribution tax.
- The salary sacrifice contributions and earnings on them are subject to preservation, which means the earliest most individuals (born prior to 1 July 1960) can access them is permanent retirement from the workforce at age 55. There is a "phase in" (1960–1964) regarding preservation, meaning a person born after 30 June 1964, has a preservation age of 60.
- If the ultimate benefit is taken as an income stream and the recipient is age 60 or more the income stream is tax free.
- Employers may restrict the amount that can be salary sacrificed up to the age based tax deduction limits for superannuation contributions.

Salary sacrifice contributions **may be inappropriate** in the following situations:

- Where individuals require the extra cash flow to meet their living expenses (including the repayment of non-tax-deductible debt).
- Where individuals have planned capital expenditure such as home renovations in the immediate future (say within 18 months) and require the cash flow to meet that expenditure. It does not usually make sense to pay more interest than necessary on a non-tax-deductible bank loan.
- Individuals on the lowest marginal rate of tax.

Salary sacrifice contributions are **most appropriate** for individuals who are on the highest marginal tax rate.

Salary sacrifice contributions **may also be appropriate** for individuals who do not fall into either of the above categories but it will depend on the particular circumstances.

The ongoing advantage of salary sacrifice contributions is that the money will be invested in the tax effective superannuation environment where investment earnings on the contributions are taxed at 15%. For individuals on the higher marginal rates of tax, this will generally be more tax effective than investing in their own name where the investment earnings will be taxed at more than 15%.

Structure of Salary Sacrifice Arrangements

Salary sacrifice arrangements that are not properly structured may be subject to A.T.O scrutiny and there is a danger these arrangements would be deemed to constitute tax avoidance. For instance, an invalid salary sacrifice arrangement would be one where the gross salary is paid to the employee directly and the employee redirects that gross salary into the superannuation fund.

Taxation Ruling TR 2001/10 issued by the A.T.O outlines the Commissioner's views on the consequences for employees and employers using salary sacrifice arrangements. The A.T.O's view is that a valid arrangement is one where an employee forgoes future or prospective entitlements to salary or wages (providing all relevant administrative procedures are adhered to). Conversely, retrospective salary arrangements are not valid and such payments would be considered to be income of the employee.

A retrospective salary sacrifice arrangement involves an employee directing a present entitlement to salary or wages be paid in a form other than salary or wages. Note than an employee is considered to have a present entitlement to salary or wages for services performed over a period even if the employee is not paid until a later period. For instance, an employee who will be paid on 30 August cannot on 25 August stipulate that their salary be salary sacrificed. This is because services have already been rendered for the period and the fact the salary has not yet been paid is irrelevant. The ruling should be consulted for those wanting more details.

Salary sacrifice arrangements that follow the guidelines below are likely to be considered valid and in accordance with the Tax Office's approval:

- The employer initiates the arrangement in conjunction with the employee's consent;
- The employer documents the arrangement as an offer;
- The employee signs an acknowledgement agreeing to accept the offer of the superannuation and salary arrangement made by the employer; and
- Arrangements are then put in place on a prospective basis.

MOVING ASSETS INTO SUPER PRE-RETIREMENT

There are many good reasons for setting up your own self-managed super fund (SMSF) or investing via a public offer discretionary master trust.

Broad choices of managed and direct investments are available, and you can decide when assets are bought and sold.

Another key benefit is that you can usually transfer the ownership of certain assets directly into your fund. By making what is known as 'in specie' super contribution, you can take advantage of the low tax rate on investment earnings and make your retirement savings work harder.

If you own an asset outside super, you pay tax on the investment earnings at your marginal rate (which could be as high as 47%). However, if you transfer the ownership of certain assets into super, the investment earnings will only be taxed at a maximum rate of 15% - a tax saving of up to 32% pa.

Admittedly, the change in ownership of the asset may mean that capital gains tax (C.G.T) is payable. Nevertheless, the long-term benefits of a lower tax rate on investment earnings may more than compensate for any potential C.G.T liability.

Given that equity markets remain depressed, the time may be right to consider this strategy.

You may also be able to minimise your C.G.T liability if you have any accumulated capital losses or you are eligible to claim your super contributions as a tax-deduction.

ACCESSING SUPERANNUATION BEFORE RETIREMENT

From 1 July 2005, a person who has reached their preservation age has been able to access their superannuation benefits in the form of a non-commutable income stream without having to retire or leave their current employment.

Also, an account based pension taken under these provisions can be stopped at any time and restarted at a later date. These measures are designed to cater for more flexible working arrangements towards the end of a person's working life. This is an investment product that provides the investor with an income stream without the facility to cash out lump sums.

The following case study shows the benefits of working part-time, as opposed to entering full time retirement.

Case Study

Paul is a single 58-year-old. He currently has a full-time position earning $50,000 gross per year. However, for health reasons he can't work full-time, but he would like to continue to only work 2 – 3 days per week. He understands that the income from part-time work of say $25,000 per year (before tax) is insufficient to meet his income needs of $35,000 per annum. Paul currently has $350,000 in super and it is all preserved.

As Paul is over 55 years of age he has the flexibility to semi-retire and still meets his income needs. The longer he is able to continue to earn an income from employment without drawing down on his investments, the better his long-term retirement position can be.

Paul could continue to work part-time and receive an income of $25,000 per annum before tax. He could invest $350,000 from his super into a non-commutable account based pension and draw the minimum income of $14,000 in the first year at age 58. Although he cannot currently make lump sum withdrawals from this pension, he will be able to access the capital when he retires or turns 65.

ACCESSING SUPERANNUATION AFTER RETIREMENT

"Preservation age' is the age at which a super fund member can gain access to benefits that have accumulated in a superannuation fund or retirement savings account, provided that the member has permanently retired from the workforce.

Depending on a taxpayer's date of birth, this age is between 55 and 60.

Since 1 July 2005, the Transition to Retirement rules has proven popular as a means of swapping a current employment income stream with a more tax effective pension. For taxpayers winding down their employment, the transitional pension enables a "top up" to their income levels.

An added advantage is that members are able to access the nil tax rates in a super fund (earnings on segregated assets supporting current pension liabilities) earlier in time than waiting for full retirement.

This strategy should be considered by anyone who is not otherwise able to access the maximum deductible contribution each year. Here we are dealing with someone with insufficient income to support their living expenses and the maximum level of contribution. The recommended course of action is to salary sacrifice employment income up to the maximum contribution limit, thus obtaining the maximum benefits of superannuation, while topping up their living requirements with a tax effective income stream from the fund.

Note that as discussed above, the tax exempt status on income assets (within the SF) financing the transition to retirement pension was removed from 1 July 2017. The normal earnings rate of 15% will apply.

PURCHASE LIFE AND TPD INSURANCE TAX-EFFECTIVELY

Many people take out insurance via a personal policy in their own name. However, if you are able to make salary sacrifice contributions, you are eligible for a Government co-contribution, you have a low-income spouse or you are self-employed, you should consider the benefits of insuring through a super fund.

By holding life and total and permanent disability (TPD) insurance through super, you may be able to reduce the effective cost of your premiums – in some cases by up to 47%. When you take into account the potential tax savings, it is also possible to purchase a higher level of cover, when compared to insuring outside super.

The same tax deductions and offsets that apply when investing in super also apply to insurance purchased through a super fund.

- **If you are eligible to make salary sacrifice contributions,** you may be able to purchase insurance through a super fund with pre-tax dollars.
- **If you are employed, earn less than $51,813 pa and make personal after-tax (non-concessional) super contributions,** you may be eligible to receive a Government co-contribution that could help you cover the cost of insurance.
- **If you make super contributions on behalf of a low-income spouse,** you may be able to claim a tax offset of up to $540 pa that could be put towards insurance premiums for you or your spouse.

These tax outcomes can make it significantly cheaper to insure through a super fund. All you need to do is nominate how your contributions should be allocated between your super investments and your insurance policy.

BINDING NOMINATIONS

Where Will You Super Go When You Die?

When it comes to allocating superannuation benefits from a deceased estate, your Will won't always provide the final word. Setting up a valid binding nomination can ensure you determine who receives your superannuation.

Many people assume their Will controls how their estate will be divided when they die. While this is true for assets like property and cash, the same rules don't necessarily apply when it comes to deciding what happens to your superannuation.

Special rules control how super fund Trustees are allowed to distribute superannuation from a deceased estate, and how that money will be taxed.

Knowing how these rules work, including the use of binding and non-binding nominations, can help make things easier for those who will be financially affected by your death.

When you join a super fund, you will be asked to nominate who you want your death benefit paid to, either as a 'non-binding' or 'binding' nomination.

Non-Binding Nominations Give the Trustee Final Say

A non-binding nomination is a preferred nomination only. The Trustee will take into consideration any nomination you make, but a non-binding nomination gives the Trustee final discretion in deciding who will receive your superannuation benefit when you die.

Binding Nominations Give the Final Say

A binding nomination allows you to decide which of your dependents receive your benefit when you die, and how much of the benefit they receive. Binding nominations ensure you decide how your superannuation is distributed rather than the Trustee. The nomination requires two witnesses' signatures and is only valid for three years from the date it is made. For many funds, a binding nomination will revert to being non-binding after a three-year period if the nomination is not confirmed and no new nomination is made.

Ensuring Your Binding Nomination Is Valid

To ensure your binding nomination meets the requirements of the Trustee, you should:

- Only nominate dependents or a Legal Personal Representative as beneficiaries;
- Formerly you had to review and update your nominations every three years.

However...

Tips on How to Make Allocation of Your Superannuation Easier

It only takes a few simple steps to make things easier for everyone if you are a member of a super fund when you die:

1. Nominate who you want to receive your death benefit.
2. Keep your nomination up to date, especially if your wishes or personal situation changes (for example, you re-marry) for binding nominations. This can stop people from arguing that your nomination is no longer useful or relevant.
3. Let your fund know if you have several dependants. You can explain your wishes for each of them, which is far more helpful than giving your fund no guidance at all.
4. Explain your wishes to your dependants, to help prevent any disputes after you die.
5. Talk matters over with people who may need to prove their financial dependence on you. It can help to give them easy access to relevant financial records or written agreements about the support you were giving them, in case they need to prove their claim.
6. Renew your binding nominations every three years

Saving On Capital Gains Tax in A SMSF

Be aware of the potential to save on C.G.T by realising capital gains after your SMSF starts a pension, rather than while still in the accumulation phase.

All super funds pay tax on their investment earnings at a concessional rate of 15 per cent. Like individual investors, they are entitled to a C.G.T discount if their investments are held for 12 months or more. For Super funds, the discount means they are only taxed on two-thirds of any realised capital gains, which translates into an effective C.G.T rate of 10 per cent. However, pension funds pay no tax at all on their earnings. So if you defer an asset disposal until you're in the pension phase, your capital gain is tax-free. For the many SMSFs which buy and hold assets for long periods, that can translate into significant savings.

If you do not have a SMSF it's worth a number of 'wrap'-style super noting accounts can offer a tax-free transition from super savings to pension. This is because there 'wrap' style arrangements attribute the savings to individual members rather than pooling them together.

Superannuation Funds and G.S.T on Residential Property SMSF

Superannuation is deemed by the G.S.T laws to be a financial service meaning it is generally taxed at the input stage. That is, G.S.T will apply to many of the goods and services super funds purchase to provide services to their members but G.S.T is not charged on the member services themselves.

Super Funds often have to deal with reduced input taxed credits. Only enterprises can be registered for G.S.T purposes and a super fund is specifically deemed by the G.S.T laws to be carrying on an enterprise.

However, most small super funds do not have to register for G.S.T because the value of their G.S.T taxable supplies is less than the $75,000 p.a. G.S.T turnover threshold.

A super fund that doesn't have taxable supplies exceeding $75,000 may elect to register for G.S.T in order to claim its input taxed credits. Those super funds that do register for G.S.T need to realise the additional work required to administer their G.S.T obligations is often not worthwhile. If a super fund provides G.S.T-taxable goods or services that have a commercial value of more than $75,000 it has no choice but to register for G.S.T.

Usually SMSFs that must register for G.S.T do so because the fund owns commercial property and G.S.T applies to all non-residential properties.

Increasing numbers of SMSFs are now engaging in the building and development of residential property.

Let's consider how G.S.T applies to residential transactions.

In the event the SMSFs trustee leases out the property upon completion, we are then dealing with an input taxed situation for leased residential property. This means even if the SMSF is registered for G.S.T, then the G.S.T on all building costs can't be claimed.

However, if a G.S.T registered SMSF sells such a property upon completion (or as soon as possible thereafter), then the input tax credits on some or all the development costs can be claimed.

If instead substantial renovation was involved, then input tax credits on relevant repair or improvement costs could also be claimed.

What happens if a sale cannot be achieved because of changed market conditions resulting in the super fund trustee renting out the property? These changed circumstances have G.S.T implications covered in G.S.T Ruling 2009/4 – see our Tax Effective Shares & Property Update issue #0089.

SMSFS – FURTHER GUIDANCE ON LRBAS WITH NO ARM'S LENGTH TERMS AVAILABLE NOW

Non-arm's length limited recourse borrowing arrangements (LRBAs) further guidance is now available.

Taxation Determination TD 2016/16 was released on 28 September 2016 and replaces the views in ATOID 2015/27 and ATOID 2015/28. TD 2016/16 follows the release of the A.T.O's Practical Compliance Guideline which sets out when the Commissioner will accept that an LRBA is structured on arm's length terms.

The taxation determination follows feedback received after the issue of PCG 2016/5 in April 2016 that questioned how the non-arm's length income (NALI) provisions apply, in circumstances where an arrangement isn't on arm's length terms.

The approach adopted in TD 2016/16 actually means that in some very limited circumstances, the NALI provisions may not apply to an arrangement, even though it's not on arm's length terms. However, the taxation determination highlights that for the vast majority of cases, if there is an LRBA that is not at an arm's length terms, NALI will arise and the relevant income in the SMSF will be taxed at the highest marginal tax rate of 47 per cent.

To avoid the possibility of the income being taxed at the highest marginal rate of 47 per cent, SMSF trustees should ensure any LRBA they enter into is on arm's length terms. Such terms may be in line with the safe harbours provided in the A.T.O's PCG, or benchmarked against those offered by a commercial lender in the same circumstances.

SMSFs contemplating an LRBA on non-arm's length terms are strongly encouraged to seek independent professional advice, or to seek a private binding ruling from the A.T.O.

PROPERTY DEVELOPMENTS IN SMSFs

Advisors often field calls from SMSF Trustees seeking to invest in property to make a short term and more substantial gain than a passive investor.

SMSF trustees may increase the value of their property by repairs, improvements and development undertaken by the members or related parties themselves. However, it is crucial that every property investment and related party activity must be carefully documented and managed.

However, it should be noted a SMSF should generally not acquire any assets such as materials or property from fund members or associates.

Section 66(1) of the SIS Act stipulates an SMSF trustee must not acquire assets from a member or related party of the fund unless the property is business real property.

It could be an issue if a member or related party pays for goods and materials used in the improvement or construction of a property.

Under the "doctrine of fixtures", if a fund member affixes something to an SMSF's land, that thing becomes part of the land.

The A.T.O has confirmed where the materials are "not insignificant" in value and function; the materials will be considered an acquisition by a superannuation fund trustee (SMSFR 2010/1 [19]).

This could result in a contravention of section 66 of the SIS Act with substantial penalties.

The SMSF trustees should acquire required materials directly from an unrelated supplier and pay for them from the SMSF's own bank account.

Alternatively, the materials could be acquired by the member or related party via an agency or bare trust arrangement that recognises the SMSF trustee as the party acquiring the materials.

It is possible for a SMSF to authorise a related party builder to operate a special bank account under an agency agreement or bare trust to acquire materials. Specialist advice should be obtained in structuring such an arrangement.

Arms-length requirements

An SMSF should deal with other parties on arms-length terms. This rule requires parties that are not at arm's-length to make sure their dealings are.

Consider whether a prudent, arms-length person, acting with due regard to his or her own commercial interests have done it *(APRA v Derstepanian (2005)*).

It is easy to forget when related parties are dealing with an SMSF; the fund must avoid any contraventions and document transactions with related parties with sufficient supporting evidence reflecting arms-length terms. This is done by obtaining quotes from third parties and gathering suitable evidence.

On 15 December 2014 the A.T.O finally published its formal view in A.T.O IDs 2014/39 and 2014/40 on interest-free (0%) or low rate loans to self-managed superannuation funds (SMSFs) from related parties for limited recourse borrowing arrangements (LRBAs) and whether that gives rise to non-arm's length income in the SMSF.

The A.T.O considers the impact of other non-commercial terms, and the risk of those loans giving rise to non-arm's length income as well.

Exercise caution in this area and seek specialist advice.

This is thrown into sharper focus given the announcements regarding arm's length terms in the May 2017 Budget.

Partial Considerations

There are also a number of practical hurdles that need to be satisfied before an SMSF undertakes property development (even if it is not a business). Every document including contracts, specifications and resolutions must be reviewed to ensure there is no contravention of any superannuation law.

Ensure the SMSF is authorised to undertake a property investment or development, especially if it is likely to constitute a business it is possible the SMSF deed and investment strategy may need to be revised.

Property development involves significant legal and financial risk. Cost overruns are not uncommon with renovation, building and construction projects.

It is essential the cash flow and the liquidity of an SMSF can manage these risks, which may result in large sums of additional money being required to complete a development.

Limited recourse borrowing SMSFs are prohibited from borrowing money to finance improvements or develop activity. This form of borrowing only allows borrowing for an acquisition and certain repairs.

Property development can also give rise to other "general" legal risks such as tradesmen suffering injury.

It is recommended all SMSFs should have a sole-purpose corporate trustee, especially those undertaking any property investment.

Charge over assets

An SMSF must generally not give a charge over a fund asset. Many building contracts, however, provide for a charge over the land and property being worked on.

SMSFs should thoroughly inspect each relevant document, notably standard building contracts and take care to exclude any mortgage, lien or other encumbrance.

Trustee remuneration

Note a SMSF trustee must not receive remuneration for services performed in their role as trustee (section 17A of the act). One must consider when should a trustee's services cease?

It is considered that building and construction would not fall within the ambit of a typical trustee service. Thus, this provides scope for payment.

However since 2012, a SMSF has been allowed to provide remuneration where the trustee or a director of a corporate trustee provides services to a fund and is remunerated, provided the trustee or director has the requisite qualifications and licence, carries on a business or provides the same services to the public generally and charges an arms-length rate for their services (section 17B of SISA).

Once again be certain you meet all the terms and conditions.

Structures

A number of structures can be used for property development by an SMSF.

SMSF solely undertakes the development

Here the SMSF buys/owns the property and undertakes the development itself. Subject to the usual limits, additional contributions can be used to top up any extra funding that may be required.

One risk with this structure is that borrowing is prohibited unless it meets the strict requirements of sections 67A and 67B of the act. Note that borrowing to fund improvements is expressly prohibited.

Joint Ventures

An SMSF could consider a joint venture with a builder to develop land owned by an SMSF and then share the output.

One scenario would be the SMSF purchases vacant land and then under the terms of joint venture arrangement a builder builds townhouses on that land. Upon completion by both the SMSF and builder share the output.

The main advantage for SMSFs is they can use equity beyond that in the SMSF. This overcomes liquidity issues as the builder pays for the costs of developing the land.

As always the SMSF has to consider contraventions of SISA including the arms-length test and related party dealings if the builder is a related party.

Intermediary

An SMSF may invest in units of a unit trust (geared), which will buy and develop the property. This structure allows multiple investors (including multiple SMSFs) to purchase property.

Note, if the unit trust that is not a related trust is that the trustee of the unit trust can borrow to fund any shortfalls during construction when developing the property.

The trust itself is the one developing the property and therefore legal risks associated with the development are quarantined at the unit trust level.

Development Agreement

It is possible for a SMSF with landholdings to enter a development agreement with a related or independent third party.

These are similar to unincorporated joint ventures and are used to develop property where the land owner does not have the necessary cash resources – consider a farmer and encroaching suburbia.

Here the land owner enters an agreement with a developer. The land owner retains full legal and beneficial ownership in the land at all times during the development. The developer agrees to fully fund the development and only be remunerated from the profits generated from the eventual sale of the completed development.

The main benefits of such a transaction from the land owner's viewpoint are that the land owner receives funding and expertise and will only be liable to pay a commission if the transaction is successful.

Further, the developer's perspective, the agreement can also bring with it some positives. For instance, entering such an agreement to develop a property will save the developer from paying for the upfront cost of the land and for any stamp duty and related transaction costs on the "acquisition" of the property.

This is because the land owner retains ownership of the property at all times until a sale is ultimately consummated with an end user of a particular lot. Further, land tax savings can also result.

The above is not an exhaustive analysis and SMSF trustees need to follow to letter of the law and take specialist advice.

DISCLAIMER

bO2™

Corporate Essentials

Tax Smart Australia

bo2 | Corporate Essentials Pty Ltd as
Trustee for The TSA Unit Trust

ABN 70 377 440 020
ACN 119 058 310

Level 1, Suite 4, 128 Bundall Road,
Bundall QLD 4217

T 1300 55 55 33 | P (07) 5574 0555
F (07) 5574 1555 | E info@bo2.com.au

www.bo2.com.au